Startup Economics 101

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I've been a puppet, a pauper, a pirate, a poet, a pawn and a king
I've been up and down and over and out, and I know one thing
Each time I find myself flat on my face
I pick myself up and get back in the race

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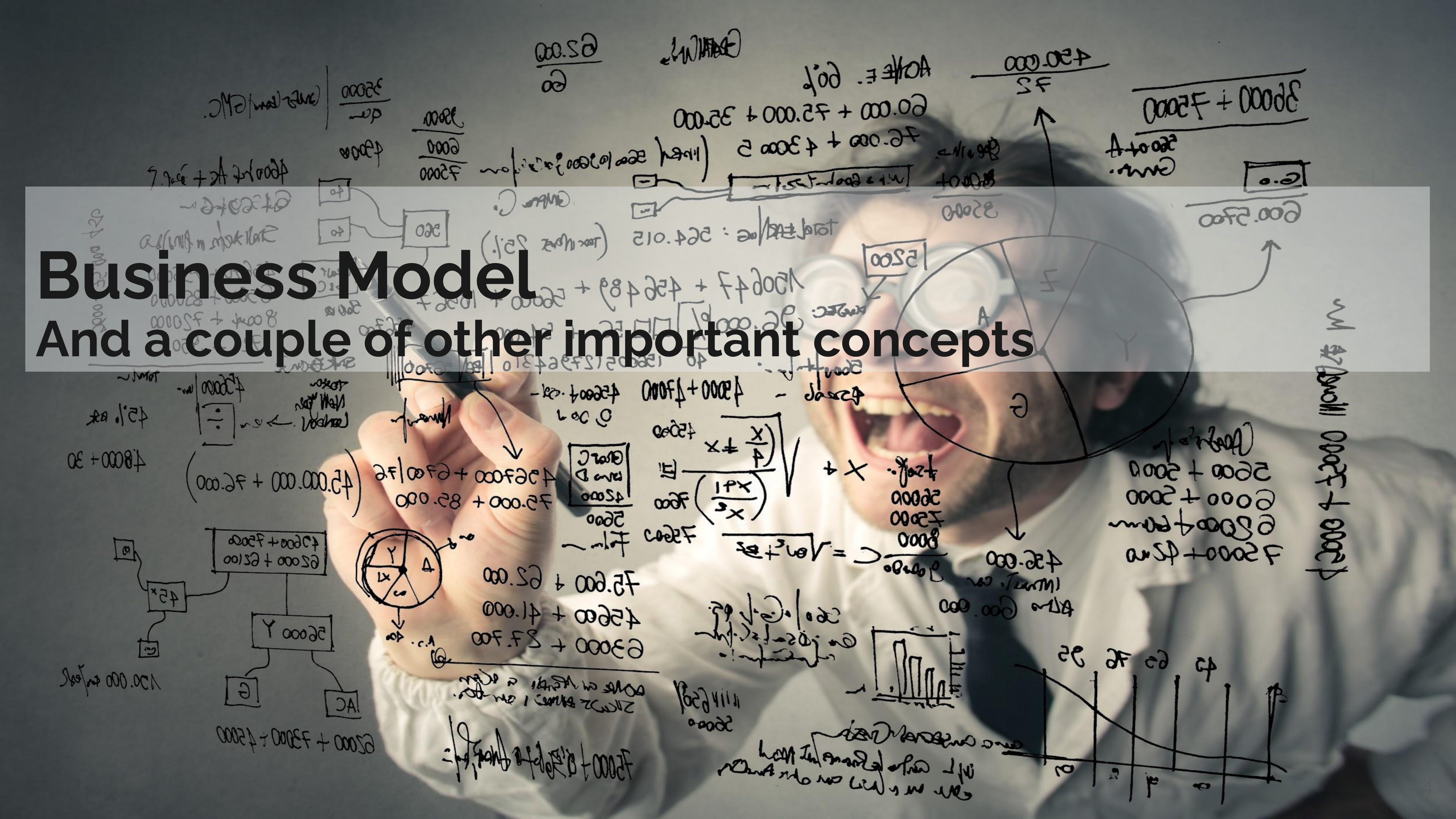


Business Model

And a couple of other important concepts

What is this business model stuff anyway?

The term business model refers to **a company's plan for making a profit**. It identifies the products or services the business plans to sell, its identified target market, and any anticipated expenses. Business models are important for both new and established businesses.

– *Investopedia*

A business model describes how an organization **creates, delivers, and captures value**, in economic, social, cultural or other contexts. The process of business model construction and modification is also called business model innovation and forms a part of business strategy.

– *Wikipedia*

More definitions

A business model should consist of four elements: a customer value proposition, a profit formula, key resources, and key processes.

– *Clayton Christensen*

The story that explains how an enterprise works.

– *Joan Magretta*

The world according to Clayton Christensen

- **Customer value proposition**: why your customers want to buy from you
- **Profit formula**: your revenue and pricing model, your unit economics
- **Key resources**: who (and what) do you need to make this happen
- **Key processes**: how do you deliver value to your customers

Startup Revenue Models (how you can make money)

Ad-Based Revenue Model

Affiliate Revenue Model

Transactional Revenue Model

Subscription Revenue Model

Web Sales

Direct Sales

Channel Sales (or Indirect Sales)

Retail Sales

Product is Free, But Services Aren't

Freemium Model

Product/Market Fit

Product/market fit happens when you have successfully identified your target customer and are serving them with the right product.

As an entrepreneur your primary early task is to find your product/market fit.

Only then can you successfully scale your company.

Revenue & Growth

So, what is revenue?

It is what you sell your product or service for.

Sort of…

If you sell to consumers (b2c), remember VAT.

If you sell through a channel, remember channel margins.
They can be up to 50%.

So what your end customer pays for you product or service may not be your revenue.

Golden rule #1:

Investors value revenue and revenue growth more than anything else

Golden rule #2:

Until they start wanting profits…

But we'll tackle that later

But that comes later. Early on, growth trumps everything else. **Go for revenue growth.**

A bit of alphabet soup:

MRR

ARR

CAC

ACV

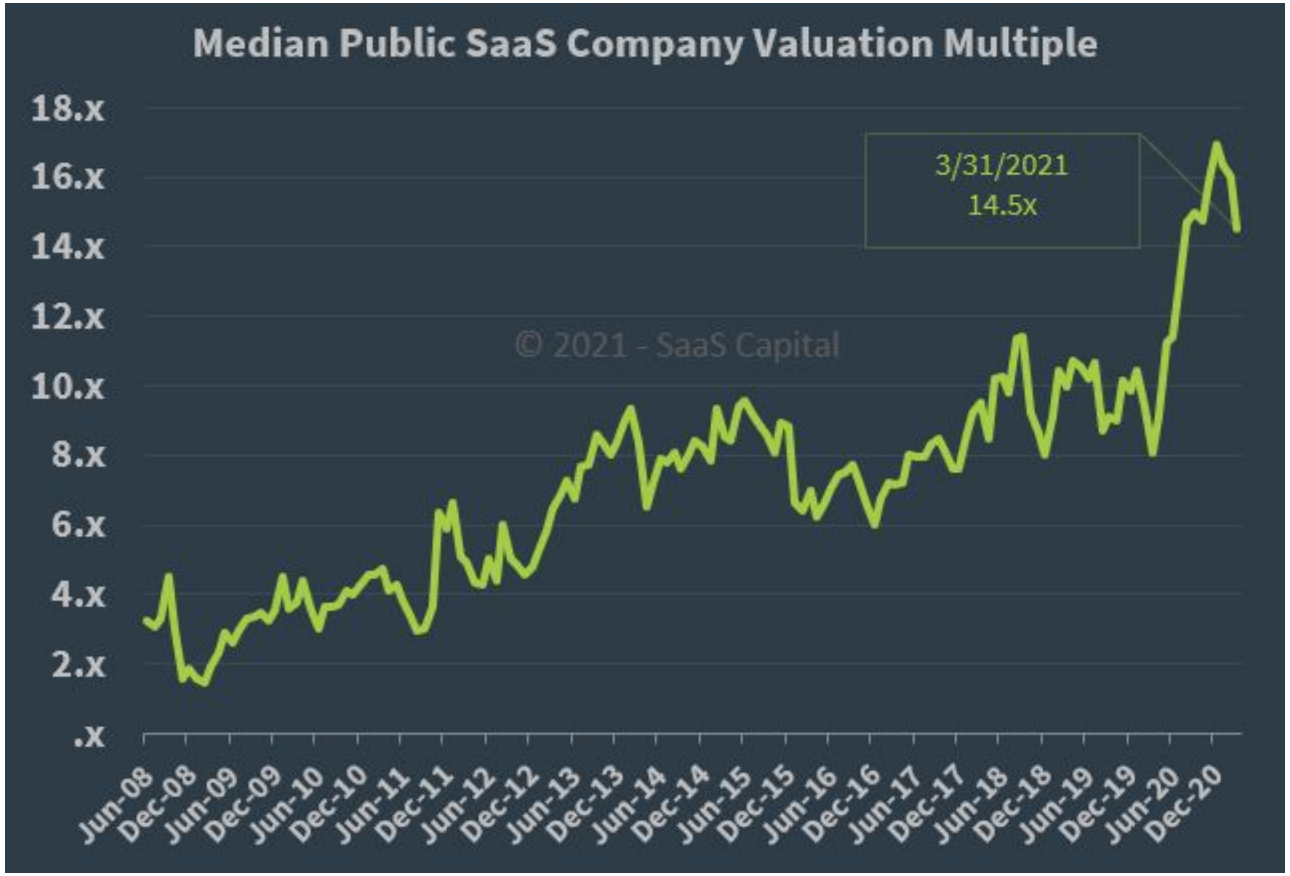
CLTV

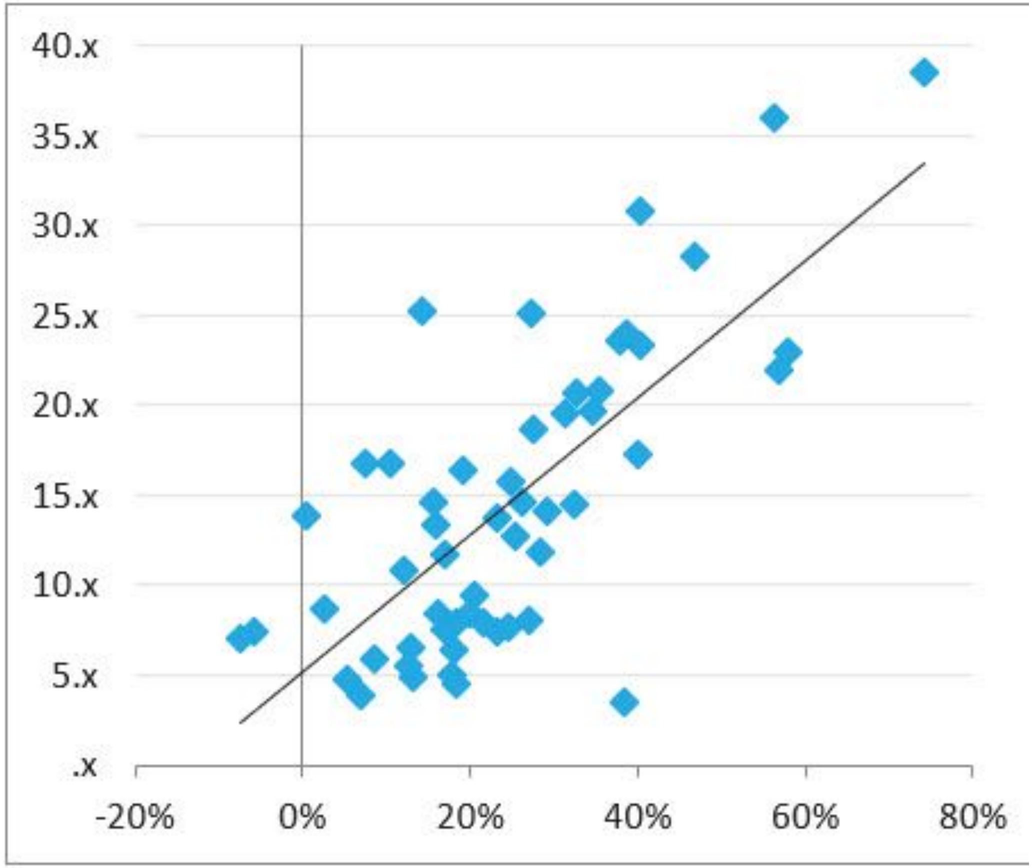
You must remember this...

MRR = Monthly Recurring Revenue
ARR = Annual Recurring Revenue
ACV = Annual Contract Value
CLTV = Customer Lifetime Value
CAC = Customer Acquisition Cost
NRR = Net Revenue Retention

New golden rule #1:

Investors value MRR and MRR growth more than anything else





Elementary, my dear Watson

COGS, CAC & Unit Economics

And other super interesting stuff…

COGS = Cost of Goods Sold

Revenue - COGS = Gross Margin

In SaaS business, you should be able to get your COGS down to 15 to 20% of revenue, i.e. your gross margin should be >80%.

If you make hardware, you should be able to achieve (over time) roughly 50% Gross Margin.

It is OK if your COGS is higher in the early going.

CAC = Customer Acquisition Cost

In SaaS business, it’s not only about your CAC, it is more about your CLTV/CAC ratio. That determines how healthy your business is.

A good rule of thumb is that the ratio should be 3 or more (but not too high).

Suppose you are launching **Grossflix**, a new streaming service.

- Your market research indicates you can charge €7 per user per month.
- You think your customers might stick around for 4 years

How much can your CAC be?

And: What factor have I completely forgotten about here?

Just don’t be like these guys…

JOKR

“Jokr, a grocery delivery startup founded in 2021, was losing $159 per order in New York City just three months into its operation, according to The Information. Other NYC-operating companies like Fridge No More were experiencing similar losses.”

…because their unit economics are seriously f*cked up

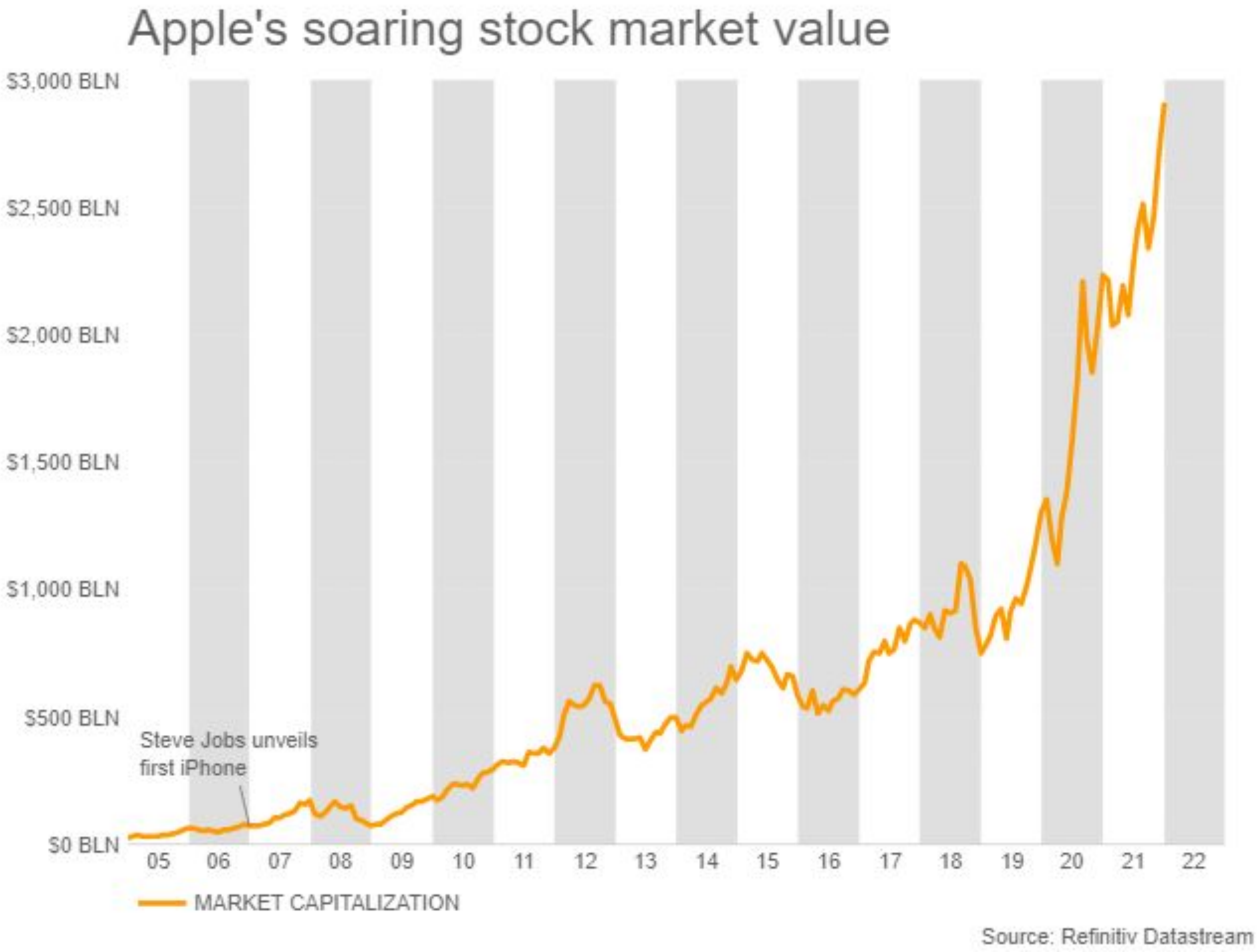
Profit & Profit Margin

The (long-term) holy grail of business

XYZ Truss Co. Income Statement 2019		
Description		**Amount**
Sales	$	1,000,000
Cost of Goods Sold	$	750,000
Gross Profit	$	250,000
Operating Expenses	$	75,000
Selling	$	50,000
Admininstrative	$	35,000
Total Operating Expenses	$	160,000
Income from Operations	$	90,000
Non Operating Expenses		
Interest on Loans	$	10,000
Pre Tax Income	$	80,000
Income Tax (25%)	$	20,000
Net Income	$	60,000

Revenue (Sales)
 - COGS
= Gross Profit
- Operating expenses
  (Sales & Marketing (CAC), R&D, G&A)
= Operating Profit

Why is Apple the most valuable company on earth?



They have grown very fast, but equally importantly Apple's operating margin is roughly 30%.

S&P average is roughly 13%.

To make a pretty long story really short, this is how it goes:

- Initially, focus on fast growth. Don’t fret about profits yet.
- But make sure that your business model allows you to turn profitable at some point. Your COGS and CAC may be too high early on, but you must be able to bring them down.
- In the long run, profit – or, more to the point, credible ability to become profitable – starts to be more important.

A bit of VC Logic

Why are they such greedy bastards?

LPs want high returns

Tier 1 LPs (fund investors) typically want up to 3X their money back in order to invest because of the high risk of VC investments.

The **Two and Twenty** Model

The VC company takes an annual management fee of 2%* and 20% of the profits (carried interest)

More than half of the companies invested in fail or provide a relatively weak return

The multiple sought must be very high or the funds do not generate enough profit

* often higher for small funds

$100 M
fund commitments

$20 M
mgmt fees

$80 M
in investments

$25 M
fails

$35 M
2X return

$20 M
5X return

$170 M
total return

$70 M
total profit

1.7X
unacceptable return for LPs

The numbers do not add up for LPs who want 3X net returns

$100 M
fund commitments

$20 M
mgmt fees

$80 M
in investments

$25 M
fails

$35 M
3X return

$20 M
10X return

$305 M
total return

$205 M
total profit

3X
acceptable return
for LPs

Now, the numbers start to make sense

Some further reading

Product Market Fit: https://www.hotjar.com/grow-your-saas-startup/product-market-fit/
SaaS Metrics: https://blog.hubspot.com/service/saas-metrics
Unit Economics: https://fundsquire.ca/guide-unit-economics/
SaaS Unit Economics: https://www.cloudzero.com/blog/saas-unit-economics
Revenue Models: https://fi.co/insight/the-10-most-popular-startup-revenue-models
More about CAC: https://blog.hubspot.com/service/what-does-cac-stand-for
More about NRR: https://www.gainsight.com/blog/nrr-north-star-growth-metric
Startup Valuations: https://www.brex.com/blog/startup-valuation/
SaaS Valuations: https://empireflippers.com/saas-company-valuation-multiples-metrics/
Revenue Models: https://www.altexsoft.com/blog/revenue-model-types/
Business Model: https://hbr.org/2011/01/how-to-design-a-winning-business-model

Case bt.tn

Fumbling towards a business model

SSH.COM

Our Timeline

Late 2013	Pre-seed funding, start of deveopment.
Q2 2014	First (paying) customers. Launch at Arctic 15.
Q3-Q4 2014	Indiegogo campaign, start of sales and marketing.
Q1 2015	General availability.
Q2-Q4 2015	Start of systematic enterprise sales, first small enterprise closes.
Q1-Q2 2016	Opening of US office, first US customers. Size of pilots grow.
H2 2016	Closing of first large enterprise sales, start of scaling up.

bt.tn

A Tale of Three Business Models

B2C

Product price 69.00€,
freely cloud configurable,
minimum order size 1.

B2B

Subscription 7.90€/month,
locked configuration,
minimum order size 100.

B2B2C

Price and functionality TBD,
reprogrammable bttn + server,
minimum order size 10,000.

bttn ONE

A flexible IoT button with 2 trigger buttons and a screen.

Product features

- Two trigger buttons on the device
- On-screen updates on workflows and automation
- 2G or 4G network with global coverage, mains powered

~~€134~~ **€120**

Upfront fee per device inc. 12 months of service, ex. taxes

Get started with a demo

See pricing

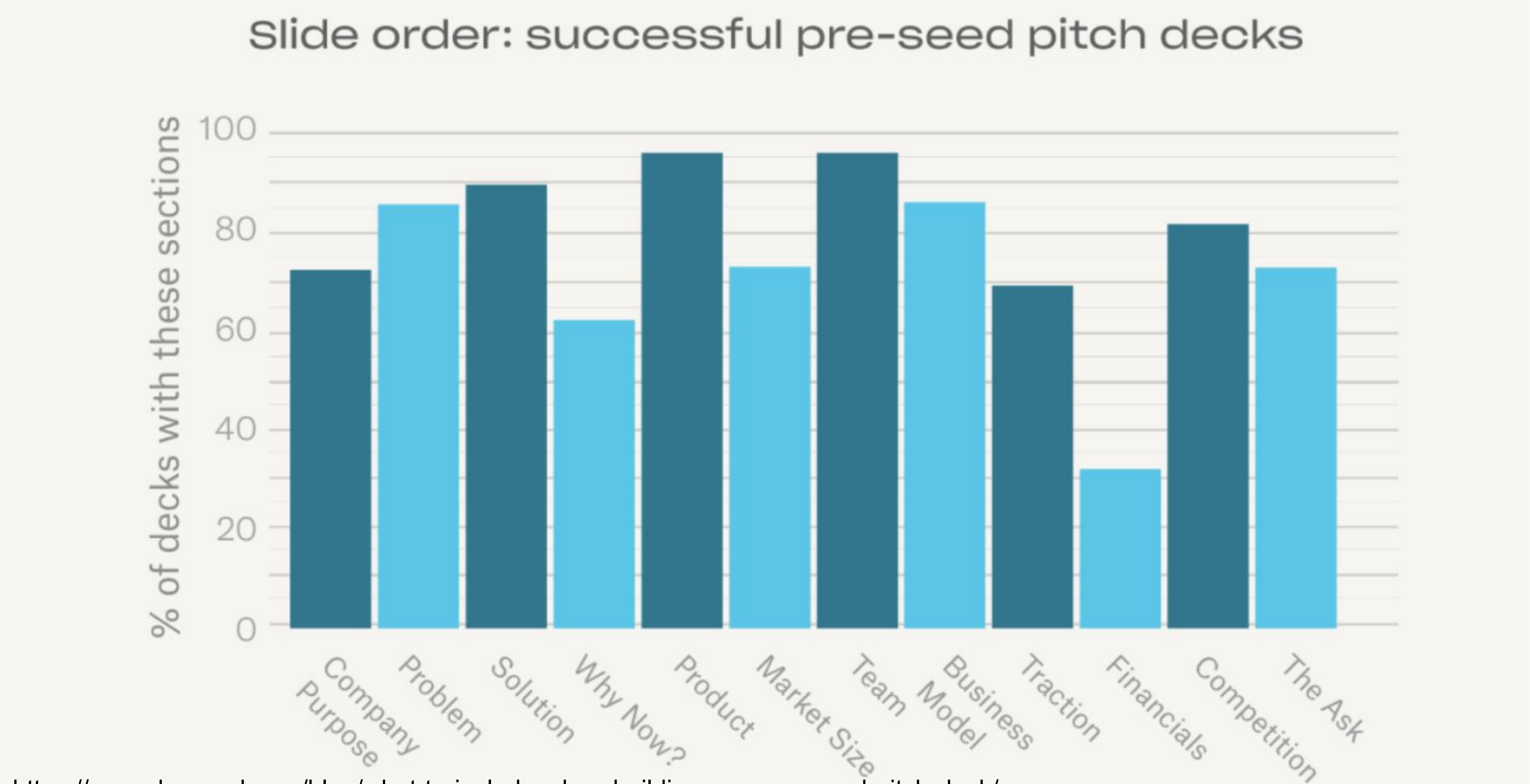
The Kawasaki Way

The only 10 to 12 slides you need

Ten is all you need

1. Introduction & Company Purpose
2. Problem Statement
3. Value Proposition/Solution
4. Undelying Magic
5. Business Model
6. Go-to-Market Plan
7. Competitive Advantages
8. Team
9. Financial Projections & Key Metrics
10. Current status, accomplishments, and use of funds

The Dirty Dozen



https://www.docsend.com/blog/what-to-include-when-building-your-pre-seed-pitch-deck/