Startup Revenue Models (How to choose your clients!)

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Agenda

- About Dave
- Why Startup Fail and Yours Shouldn't
- Market Valuation Drivers
- Company Valuation Drivers
  - Creating, Delivering, & Capturing Value
- Revenue Models
  - The Data
  - The 14

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About Dave

- 5X founder, raised $12M, exited $85M
- Former SVP Programs at UP Global (Startup Weekend)
  - Startup Next creator, Startup Week
- Author – "Trajectory: Startup – Ideation to Product Market Fit" shipping today!
- 2X VC and random Angel
- >15 transactions – now with NextPath Advisors

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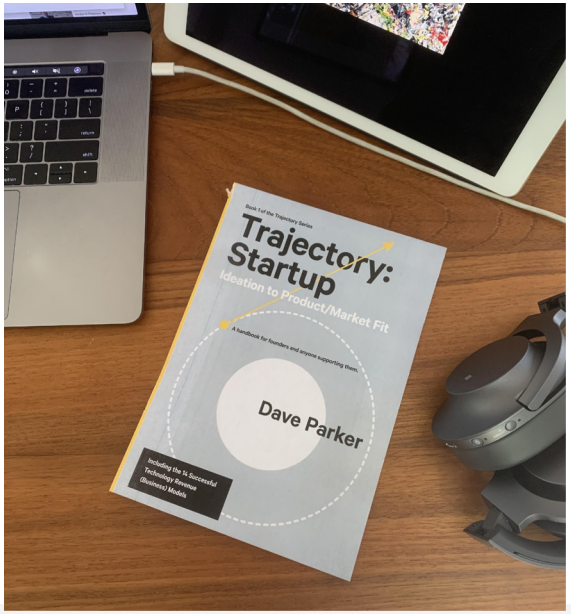
Resources

- www.dkparker.com
- 14 Revenue Model Excerpt
  - https://www.dkparker.com/trajectory-excerpt/
- Amazon Book Order



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Ignore the Memes!

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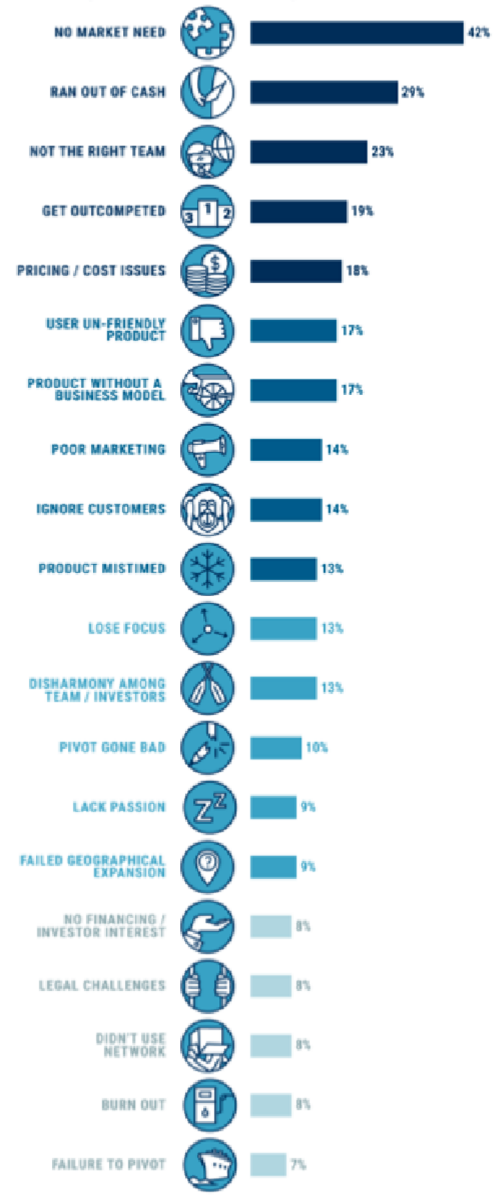
BASED ON ANALYSIS OF 101 STARTUP POSTMORTEMS

Top 20 Reasons Startups Fail



Some Calculus

- Great Team in Bad Market = Failure to meh result
- OK team + Great Market = could be great result
- Great Product + no path to revenue = failure
- OK product + great monetization = make $$
- Great Product + solid monetization + great market + great execution = monster result

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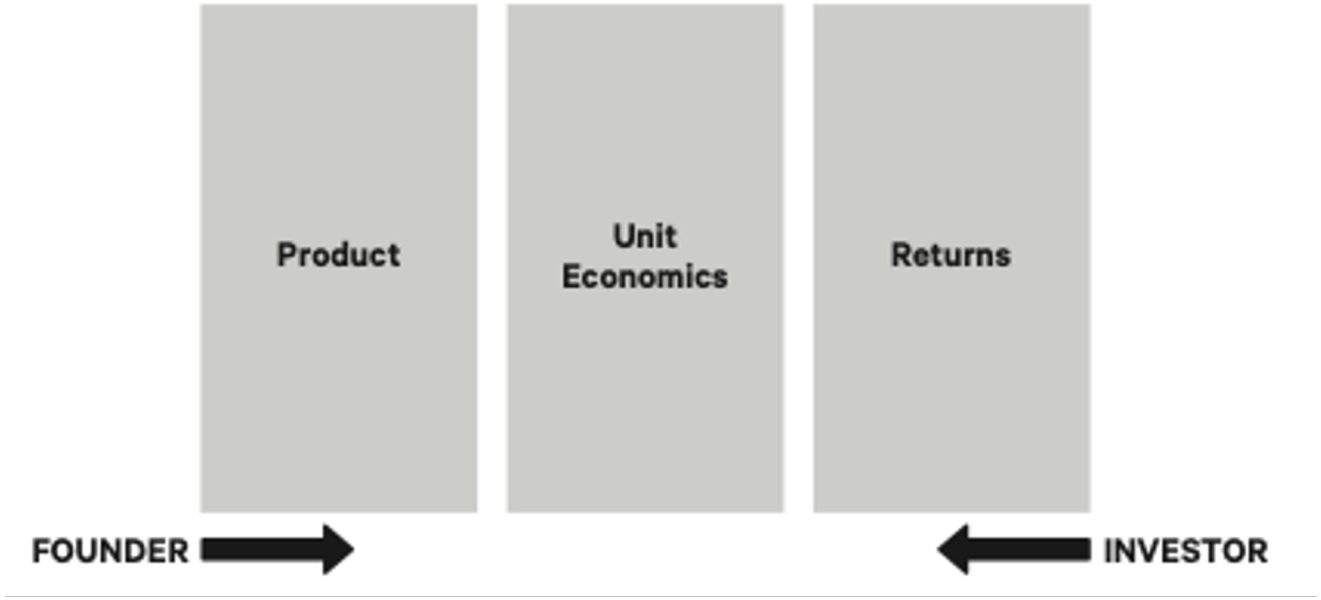
Two Views of Startups



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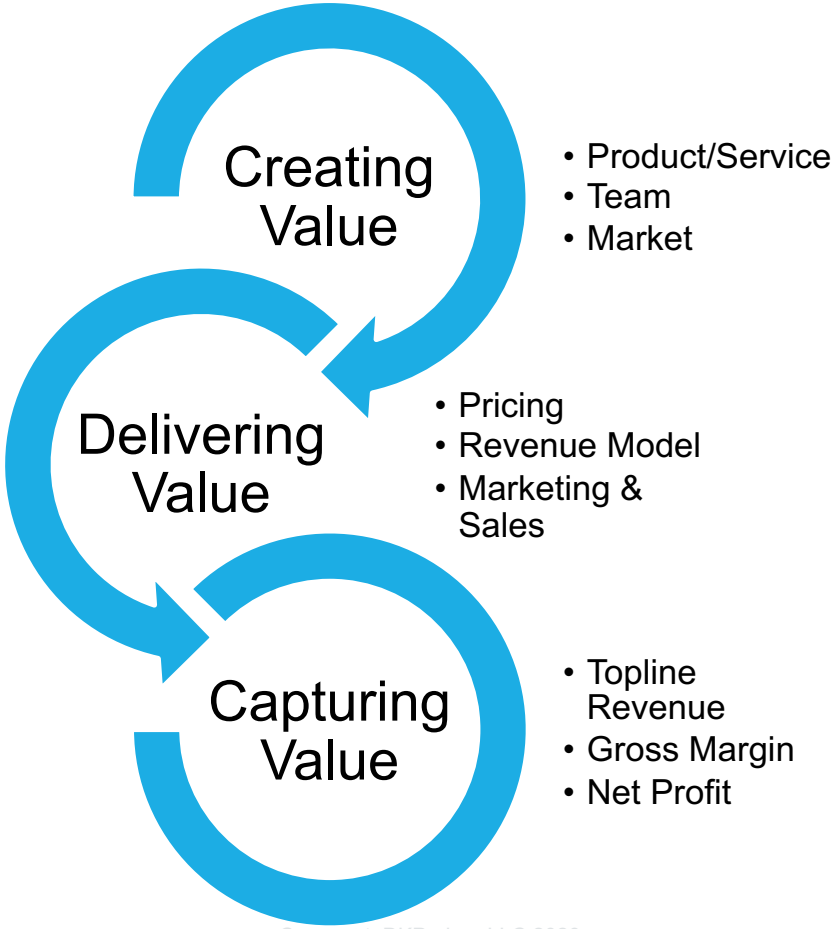
Business Model Breakdown



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Creating Value

- Product or Service or combination
- Cost to Build – Team
  - Engineering
  - Design
  - Hosting
  - Manufacturing
- Cost of Delivery & Support

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Delivering Value

- Revenue Model
- Pricing
- Customer Acquisition Cost (CAC)
  - Marketing Methods and Spend
  - Sales Models
- Lifetime Value (LTV)
- Note Promotions are not pricing or revenue models (e.g. freemium is a promotion)

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Capturing Value

- What's left over!
- Topline Revenue
- Gross Margins
- Net Profit

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Product/Market Fit = Math

- PMF means being in a good market with a product that can satisfy that market (no more pivots)
- Pre-PMF looks like pre-compound interest, leading indicators:
  - Leads are increasing (top of funnel)
  - Closing ratios are increasing
  - Time to close is decreasing
  - ACV/MRR is increasing
  - Referrals are increasing
  - Time on site/app is increasing

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How to Monetize: Revenue Models

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This isn’t a calculus for valuations - it’s a heuristic

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The Data

- Background – revenue templates
  - 2654 companies from Crunchbase
  - 5+ year tracking
  - Surprises
    - Seed 1-10
    - Combinations models
      - * on short time from Seed to A
    - Failures
      - Wayback Machine
      - >80% lacked clear CTA and Value Prop

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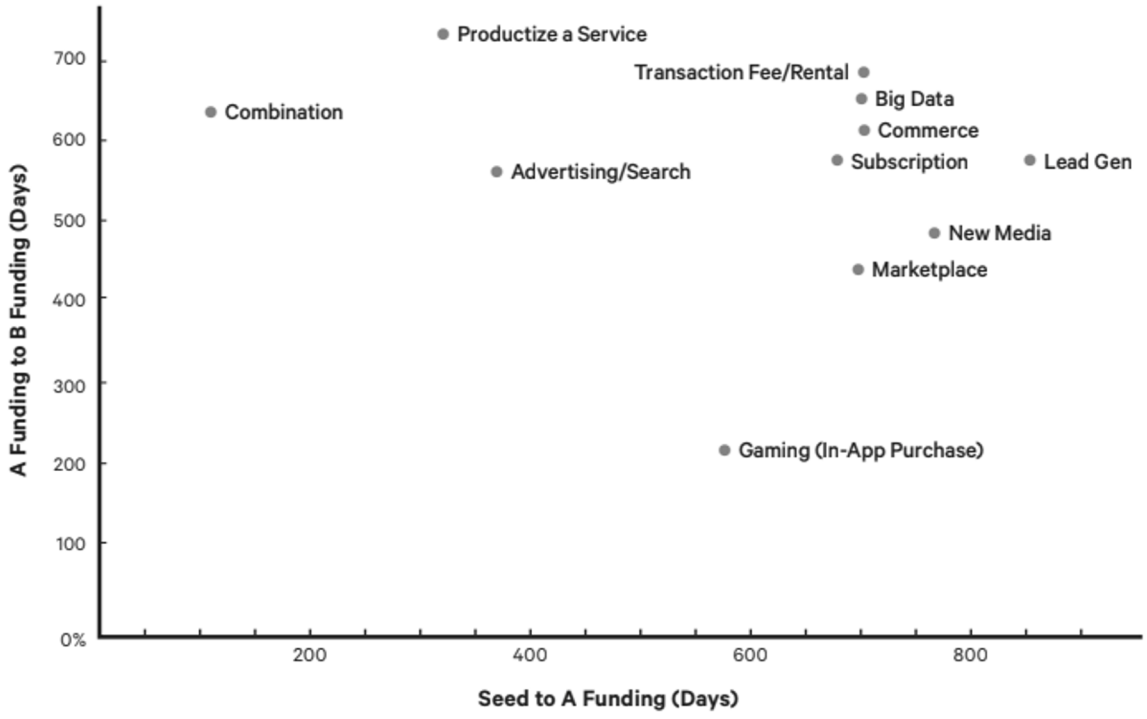

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1. Fee for Service

- Example: Accenture, Stride (Education)
- Use: B2B & B2C
- Key Metrics
  - Project Revenue
  - Cost of delivering (usually time)
  - Gross Margin
- Services are hard to scale because they require people to deliver including Restaurant, Contractors, etc.
- Services include markup on cost of goods sold

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2. Productize a Service

- Example: SW Airlines, Guidant Financial, IBM
- Your offerings is generally complex and requires services to deploy
  - Gross margin on Services >35%
  - Product development comes with services
- Use: B2C & B2B
- Examples: Moz, service company convert to tools.
- Challenges – difficult to make the transition away from services

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3. Commerce

- Example: Wayfair, Lululemon
- Use: B2C & B2B
- Key Metrics:
  - Wholesale or cost of goods sold
  - Average Margin %
  - Average Basket
- Commerce – Physical Goods- Wholesale, cost of goods, retail, average margin, physical good
- Notes: Can mature into marketplace

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4. Subscription

- Example: Salesforce, Spotify
- Use: B2C & B2B
- Key Metrics
  - Average Revenue Per User (ARPU)
  - Conversion ratio – e.g. trial to purchase
  - Churn
- Tiered pricing to optimize customer profiles/revenues
- Notes: High multiple, forecastable revenue

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5. Metered Service

- Example: Twilio, AWS, UIPath, Plaid Tech
- Use: Favors B2B
- Key Metrics
  - Average Revenue Per User (ARPU)
  - Usage growth over time
  - Churn
- Challenges: infrastructure required at launch
- Notes: Highest multiple, forecastable revenue

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6. Transaction Fees/Rental

- Example: Stripe, Chegg
- Use: B2C & B2B
- Key Metrics
  - Average transaction revenue
  - Fee % per transaction
  - Number of transactions
- Challenges: Margins are small (15%), need efficiency
- Notes: Don't start too low

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7. Marketplaces

- Example: eBay, Alibaba, Uber
- Use: B2C & B2B
- Key Metrics
  - Average Transaction Amount
  - Number of Monthly Transactions
  - Commission %
- Challenges: two sided marketplaces require you start with one side, value to seller & Product market fit (x2)
- Notes: critical mass or marketplace required

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8. Combinations

- Example: SmartSheet, conglomerates at scale
- Combination business models happen for two reasons
  - You don't know which model is right
  - At scale you can expand revenue sources
- Examples: Hardware sensors + software services to create data analytics. At Scale, Amazon, Microsoft
- Challenges – most require scale or at least traction
- Mature faster

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9. Gaming

- Example: King.com/Candy Crush, Blizzard
- Use: B2C Only
- Key Metrics:
  - Downloads
  - % play
  - Average in app purchase
- Challenges – tends to be “hit driven business”
- Notes: use in first 21 days is a predictor of success

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10. Advertising/Search

- Example: Google, Facebook
- Use: B2B – advertisers pay, users are free
- Key Metrics
  - Traffic
  - Click
  - Avg. revenue/click
- Challenges – Scale, need >1M uniques/month to consider the option

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11. New Media

- Example: SnapChat, Clubhouse
- Use: B2C only
- Key Metrics:
  - K-Factor (Viral Co-efficient)
    - Network effect of inviting others to join
- Challenges – K-Factor is hard. Little revenue until scale
- Notes: Everyone wants to! Not happening in B2B
- No revenue actually required – GREAT mulitple

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12. Big Data

- Examples: PatientsLikeMe, Splunk
- Use: B2B
- Key Metrics:
  - Per API Call
  - Per record pricing
  - Frequency/recency
- To monetize data, you need to have the data in advance or massive cash

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13. Lead Generation

- Example: Mint.com, Chime.com, AllStarDirectories,
- Use: B2C (selling consumers data), B2B
- Key Metrics
  - Cost to generate traffic
  - % conversion of form data
  - Price per lead
- Challenges: Highly competitive, barrier of entry is low
- Notes: Conversion rates average 0.06%

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14. Licensing

- Example: Think Microsoft office license or server license – before subscription. Content Licensing
- Use: B2B
- Key Metrics:
  - Duration of license
  - Upgrades & maintenance (20-25% annually)
- Use can be based on vertical market or geography

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Revenue Models– Primary/Secondary

1. Fee for Service
2. Productize a Service
3. Commerce
4. Subscription
5. Metered Service
6. Transaction Fee/Rental
7. Marketplace
8. Combinations
9. Gaming
10. Advertising/Search
11. New Media
12. Big Data
13. Lead Generation
14. Licensing

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Public Comps

- Public companies are the likely buyer, if you're going to be acquired, it's a good place to start
- You can get their Enterprise value
  - Price (market cap)/Sales (ttm) Ratio
  - Most early-stage companies don't have profit, so valuing based on EBITDA or Earning (PE) is rough
- Notes:
  - Combination models aren't clearly calculated
  - Current stock prices reflect Covid Era pricing (ttm)

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Public Multiples

	Model	Example	Price/Sales Ratio (TTM)
1	Services	Stride, Accenture	.75-1.5X
2	Productize a Service	SWAir, IBM	1-2X
3	Commerce	Wayfair, Lululemon	4-5X
4	Subscription	Salesforce, Spotify	8-12X
5	Metered Service	Twilio, AWS, UIPath	24X
6	Transaction Fee/Rental	TripAdvisor, Chegg	12-15X
7	Marketplace	eBay, UBER	4-8X
8	Combinations	SmartSheet, Amazon	8-12X
9	Gaming	Activision - Blizzard	7-10X
10	Advertising/Search	Alphabet, Facebook	7-9X
11	New Media v. Old	Snap	3-23X
12	Big Data	Splunk, Plaid Tech	8-10X
13	Lead Generation	Chime, Mint	4-5X
14	Licensing	Broadcom, Oracle	5-9X

Other Influences on Valuation

- Rule of 40 – Growth or Growth and Profit >40%
- Logical and acquisitive up market buyers
- Capital to Revenue is under 3:1 (prefer 1:1)
- Create competition between buyers

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Summary

- Dave did not say: This is not a method your companies can use to calculate your current valuation of a pre-revenue company!
  - Too many variable at early revenue stage to calculate
  - See Berkus Method for a 20 year method
- It can help them pick potential buyers
  - Based on track record (size/stage/tech)
  - Business Development as a process
- The data is still a work in progress
- Startup need to be creative, in product and marketing. Not revenue models

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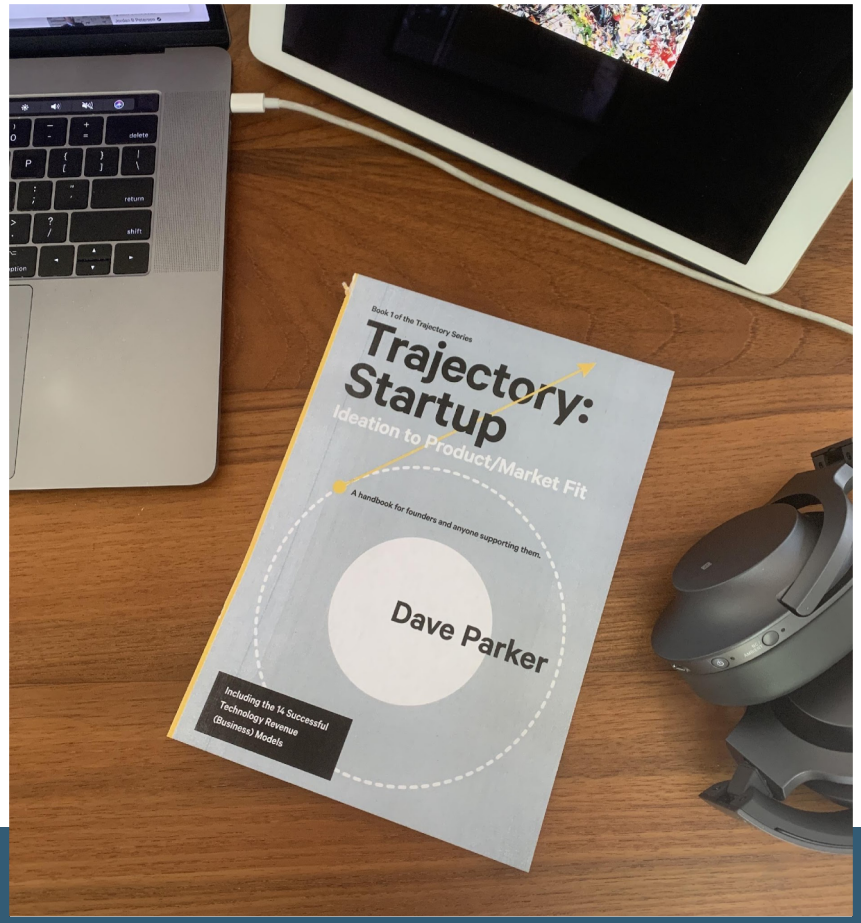

Q&A

Available at Amazon.com

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