Cozad Workshop: Revenue Models, Pricing and Projections

March 2, 2017
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Revenue Models

...how a business generates revenue streams from its products and services.

Selling Physical Goods

Selling Digital Goods

Subscription
Revenue Models

- Advertising
- Commissions / Referrals
- Marketplace
- Freemium
Revenue Models

How to choose the best revenue model?

• Focus on your value proposition. Are you a vitamin or a pain killer?

• Ask customers how they would like to pay for the product or service.

• Experiment and iterate

• Can you have more than one revenue model?
Two-sided Markets

Can you get both sides to pay?

Would that be counter-productive?

“If you’re not the one who’s paying, you’re the product that’s being sold.”
Revenue Model Metrics

• Conversion – what percent of visitors will become customers?
• Churn – what percent of customers will purchase again?
• CLTV (Customer Lifetime Value) – How much revenue (or gross profit) will an average customer generate over time?
• CAC (Customer Acquisition Cost) – How much does it cost to acquire one customer?
• Viral Coefficient – How many new customers will each customer refer?
Pricing

Rule #1:
Price > Cost

Rule #2:
Price <= Customers’ willingness to pay
Cost-based Pricing

Price based on cost to manufacture and deliver, plus a targeted profit margin.

But costs are often underestimated:

• Marketing and Selling Expenses
• Customer Support
• Technology Infrastructure
• Administrative (overhead)

Need to understand Fixed vs. Variable Costs at different sales volumes
Competitive Pricing

Price based on what competitors are charging:
• Do customers perceive there to be a difference?
• Are you sending a signal about quality?
• Are you trying to capture market share?
• Can you maintain attractive profit margins?
Value Pricing

Price is set to capture as much of the value that customers derive as possible:

• Are you helping them make money?
• Are you helping them save money?
• Are you reducing their risk?
• Are you helping them save time?
• Are you providing some non-monetary benefit?
Value Pricing

Do you understand the real value you are delivering:

• Who are your early adopters? They should be willing to pay a higher price than others because:
  • They know they have the problem
  • They have the budget
  • They have tried and failed to make some other solution work for them

• Talk to your customers!
  • Don’t just ask “How much would you pay...?” Ask them to tell you why your product is a good fit and what it means to them.
Premium Customers/Early Adopters

They are the best customers for your product or service.

• They have a high level and/or frequent need
• They understand and agree with your value proposition
• They can be influencers of others

If you can’t find customers like this, you need to re-think your strategy.
Pricing

When in doubt, raise your price!
When your prices are too low:
• You risk losing money
• It takes a long time to reach break-even
• You dilute your brand
• You turn off high quality prospects
Pricing Resources

A Collection of App Pricing Pages:
http://leanstartup.pbworks.com/w/page/15765232/Pricing%20pages

Pricing Strategies: 13 Articles You Need to Read

“Pricing on Purpose” by Ronald J. Baker
$62.28 on Amazon (“The Lean Startup” is just $15.26!)

$66.55 on Amazon (Kindle version is just $3.33 cheaper!)
Financial Projections for Startups

DIFFICULT TO SEE

ALWAYS IN MOTION IS THE FUTURE
So Why Bother?

Financial projections demonstrate:

• Your aspirations – what you consider to be a success
• Your understanding of the key drivers of growth and profitability
• Your understanding of the key drivers of ROI
• Whether the opportunity fits an investor’s profile
What Do You Need to Know?

Answers (or best guesses) to:

• What price can you charge?
• How much will you sell in the first year?
• How fast can you grow?
• How much will it cost to produce your product/service?
• What marketing and sales activities have you planned to get customers?
• What resources are needed to support the product/service, and to operate the company?
Top Down vs. Bottom Up

• Top down:
  • “It’s a huge market, so if we get a 1% market share, we’ll all be rich!”

• Bottom up:
  • “We have a strategy for getting $X$ customers this year and $X + Y$ customers next year. We can forecast our revenue per customer and the expenses we’ll have to incur to secure and support those customers.”
Gathering Cost Information

You will likely have a pretty good handle on some of your costs, but very little information on others.

• **Best of Breed Analysis:**
  • Look at competitors’ and other comparable companies’ financial reports to understand their costs (CapIQ, Bloomberg, etc.)

• **Industry Averages:**
  • Library/online research, SBDC’s, etc.
Where Do Entrepreneurs Guess Wrong?

• Revenue
  • They project that adoption will be faster than it turns out to be
  • They underestimate how long it will take to close sales – The Sales Cycle

• Costs
  • They underestimate their G&A (overhead) expenses
  • They underestimate their selling expenses
What will an investor look for?

**You say:**
- Market Size
- Market Share
- Revenue
- Gross Profit Margin
- Operating Profit Margin
- Time to Break Even
- Financing Requirement

**They hear:**
- Can we build a big company?
- Will we be the market leader?
- Is it meaningful?
- Is there margin for error?
- Can we create value?
- Can we control our destiny?
- Can we afford it? / Is it worth it?
What Should You Include in Your Pitch?

Your investor pitch should only include highlights; enough to demonstrate:

• The size and scope of the opportunity
• The amount of investment that will be required
• The potential return on that investment
• The likelihood of an attractive exit
• The amount of time it’s going to take
What More Should You Have Ready?

A three-year projection:

• Revenue
  • Recurring Revenue vs. One-Time Sales
• Gross Profit
• SG&A Expense
• Key Drivers of Growth and Profitability
• Operating Income (or EBITDA)
• Any Significant Capital Expenditures
• Cash Requirement and Use of Proceeds (the “Ask”)
Spreadsheet Tips

• Identify Your Assumptions!
• Use Linked Worksheets
  • 12 month cash flow
  • Income Statement – 3 years
  • Balance Sheets – current and annual for 3 years
  • Cash Flow Statement – 3 years
• Templates available from SCORE
What to Include in your Pitch Presentation

• Key drivers: # of customers, # of re-sellers, sales conversion rate, etc.
• Total Revenue
  • Identify if recurring or not
• Gross Profit Margin
  • Important for physical products
• SG&A
  • Identify specific expenses if they are key, like sales and marketing, product development, etc.
• Operating Profit or EBITDA
• More detail can be provided in an appendix
## BizClarity.com Example

<table>
<thead>
<tr>
<th>Financial Projections</th>
<th>2010 ($000)</th>
<th>2011 ($000)</th>
<th>2012 ($000)</th>
<th>2013 ($000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>#Clients</td>
<td>29</td>
<td>67</td>
<td>117</td>
<td>182</td>
</tr>
<tr>
<td>Revenue</td>
<td>$370</td>
<td>1,580</td>
<td>3,590</td>
<td>7,250</td>
</tr>
<tr>
<td>Net</td>
<td>$370</td>
<td>1,580</td>
<td>3,590</td>
<td>7,250</td>
</tr>
</tbody>
</table>
ReOverThinking.com Example

### Financial Information & Projections

#### Revenue & Expense

<table>
<thead>
<tr>
<th></th>
<th>Q4 2008</th>
<th>Q1 2009</th>
<th>Q2 2009</th>
<th>Q3 2009</th>
<th>Q4 2009</th>
<th>FY 2009</th>
<th>Q1 2010</th>
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</thead>
<tbody>
<tr>
<td><strong>License / Product Services</strong></td>
<td>$0</td>
<td>$10,000</td>
<td>$15,000</td>
<td>$25,000</td>
<td>$50,000</td>
<td>$100,000</td>
<td>$90,000</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td>$5,000</td>
<td>$25,000</td>
<td>$25,000</td>
<td>$35,000</td>
<td>$60,000</td>
<td>$145,000</td>
<td>$105,000</td>
</tr>
<tr>
<td><strong>Salary</strong></td>
<td>$0</td>
<td>$50,000</td>
<td>$75,000</td>
<td>$75,000</td>
<td>$100,000</td>
<td>$300,000</td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>$10,000</td>
<td>$60,000</td>
<td>$85,000</td>
<td>$85,000</td>
<td>$110,000</td>
<td>$340,000</td>
<td>$110,000</td>
</tr>
<tr>
<td><strong>Total Expense</strong></td>
<td>$10,000</td>
<td>$60,000</td>
<td>$85,000</td>
<td>$85,000</td>
<td>$110,000</td>
<td>$340,000</td>
<td>$110,000</td>
</tr>
<tr>
<td><strong>Net Loss/Income</strong></td>
<td>$(5,000)</td>
<td>$(35,000)</td>
<td>$(60,000)</td>
<td>$(50,000)</td>
<td>$(50,000)</td>
<td>$(195,000)</td>
<td>$(5,000)</td>
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*Presented to InvestCo Ventures, Jan 16 2012*
Guy Kawasaki Example

![Graph showing sales and headcount over years.](image-url)

- HowToWriteABusinessPlan.com
### One Match Ventures Example

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
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<tbody>
<tr>
<td>Target Market</td>
<td>14,000,000</td>
<td>14,140,000</td>
<td>14,281,400</td>
<td>14,424,214</td>
<td>14,568,456</td>
</tr>
<tr>
<td>Users</td>
<td>47,452</td>
<td>180,903</td>
<td>454,991</td>
<td>837,215</td>
<td>1,308,240</td>
</tr>
<tr>
<td>Active Users, After Churn</td>
<td>3,402</td>
<td>15,587</td>
<td>37,058</td>
<td>63,930</td>
<td>93,567</td>
</tr>
<tr>
<td>% Market Penetration (Active)</td>
<td>0.02%</td>
<td>0.11%</td>
<td>0.26%</td>
<td>0.44%</td>
<td>0.64%</td>
</tr>
<tr>
<td>Revenue</td>
<td>$647,306</td>
<td>$4,708,532</td>
<td>$15,184,121</td>
<td>$32,632,708</td>
<td>$55,162,995</td>
</tr>
<tr>
<td>Expenses</td>
<td>$1,092,011</td>
<td>$4,583,543</td>
<td>$11,748,537</td>
<td>$21,555,679</td>
<td>$32,593,302</td>
</tr>
<tr>
<td>EBITDA</td>
<td>-$444,705</td>
<td>$124,989</td>
<td>$3,435,584</td>
<td>$11,077,029</td>
<td>$22,569,693</td>
</tr>
<tr>
<td>EBITDA Margin</td>
<td>-69%</td>
<td>3%</td>
<td>23%</td>
<td>34%</td>
<td>41%</td>
</tr>
</tbody>
</table>

By year 5:
- Revenue = $30-50M+, EBITDA = $10M+
- Investor look for exits of 6-12x+ EBITDA = $100M+ Sale of Company
- EBITDA margins usually range 10%-40%
- Look up public companies in your industry or reports to see what is normal

The Ask

• How much money are you trying to raise?
  • At least 12-18 months of cash runway
  • Enough for you to actually accomplish product, customer and/or financial milestones

• What will the money be used for? It should be value-creating

• Understand your audience and their capacity to invest

• Don’t propose valuation or deal terms in your pitch – you can discuss all of that later

• Are you asking for anything other than money?