COCKTAIL NAPKIN ECONOMICS

Can You Illustrate Your Money Model on 6" X 6"? Better Learn Now!

Every entrepreneur has heard about the "elevator pitch." If you want to land a 30-minute audience with a potential investor, then you better have your venture concept and value proposition nailed in a 30-second sound-bite. If done right, the first 30-seconds grants you another 3 minutes to elaborate, after which you "close" an appointment for a proper 30-60 minute presentation.

So, great! You've honed your "product pitch" and "value prop" to perfection. It's quick, succinct, and without jargon. Something a stranger off the street could easily understand. But here's where things often fall apart. Because you didn't do the same with your "Money Model." Meaning what exactly? Meaning that you didn't prepare an equally simple and succinct explanation as to how you plan to make ***real money*** with your concept.

FORGET ABOUT YOUR MARKETING; DO THE MATH FIRST!

Once a venture concept is accepted, all investors want to easily and very quickly understand how you intend to take that concept and build it into a long-term, profitable venture with significant growth potential. Sure, they want to look at your sales and marketing plan. But we're not talking about "how" you "take it to market." Not yet. Instead, investors first want to verify "how" your basic economics will even allow for a significant return on effort/investment. In fact, your business economics will generally dictate what your sales and marketing plan should look like. So forget about your marketing to start. Do your math first.

3 MONEY MODEL ESSENTIALS

There are 3 "Money Model Essentials" investors will immediately look for to determine your likelihood of success, and your most viable "go-to-market" strategies.

1. **Economics of a Single Sale**
2. **Burn-Rate & Path to Cash-Flow Positive**
3. **Accelerator Plan to Scalable Growth (The Multiplier Effect)**

Translated into simple terms:

1. How much profit (on average) do you make on a single sales transaction or negotiated deal?
2. How many sales do you need to make each month & year to cover your fixed costs and "break-even?"
3. What are the means and strategies available to generate exponential sales growth in short order?

These are basic business economics that you should have measured and memorized, and that you must be able to state clearly. They will be looking to see if you actually know them, and whether you recognize they are the critical "levers" that will drive many of your strategic business decisions. Investors may not understand every aspect of your concept in 30 minutes, but they will understand these economics. And they will more than likely identify or "guesstimate" some of them before you've even finished your pitch. So leave the Pro Forma and spreadsheets for later. If you can't speak to these three Money Model basics on the backside of a cocktail napkin early in your discussions, then you haven't finished your homework. And if you're not currently chasing investment money right now, it doesn't matter. These three Money Model essentials are critical for the effective management of your business growth, regardless. So you better know them, one way or the other.

So let's "***Learn these Levers***," by digging a little deeper into each of the them.

Economics of A Single Sale

The single most critical elements to any money model are your price point(s) and "gross" or "contribution" margin(s) on a single sale. What is the difference between your price point on a single transaction and the direct inputs required to close that one sale, known as your variable costs? The net difference or "gross" margin is what you can then "contribute" to your fixed costs and operating overhead.

Your price points and contribution margins are a fundamental indicator as to the nature of your business and what sort of sales engine you'll need to build. From that one metric, investors will determine:

- Are you a high-margin/low volume opportunity, or a low-margin/high volume opportunity?
- Is this a high-priced premium play or a lower-priced mass market play?
- Should your sales team build an engine and pipeline to chase a few big "elephants," or a lot of "rabbits?"
- How much variability is in the variable costs? Can you negotiate variable costs as sales volume increase?
- If variable costs are under-stated, can gross margins absorb some degree of profit-eating movement?
- How much money is going towards fixed costs and operating overhead on every single sale?

The variable risk of variable costs, and your estimated contribution margins, are one of the most critical levers to understand because they will very quickly indicate to an investor how much "buffer room" you have to withstand unforeseen cost complications. If you're current best-case scenario only sees you reaping 15% gross margin on a single sale, then you're not demonstrating strong economic resilience. Sure, a single sales deal for your company might be worth an average of $1 million. So that's $150,000 contribution to operating expense, right? Sounds lucrative. But what if you discover, after testing the market, that unanticipated input costs decrease average margins to only 10%? That's a big change in your economics - both as a percentage, and in terms of real dollars.

Investors feel much more comfortable when gross margins begin well above 50%. Because then they know your venture has at least some built in resilience to mitigate the unforeseen. After that, perhaps you need to revisit your pricing strategy. And if you're forced to increase pricing to gain resiliency, then perhaps you're no longer a lower-priced majority market play? That decision may have just turned your venture into a niche, specialty of luxury item of some kind. Or you may have priced yourself out of the market entirely, which now means you need to revisit your total cost structure for variable inputs.

Whatever the story, you better know it. And know it well. And be able to defend it. Whether you're speaking to an investor, your Board Treasurer, or your own in-house financial controller.

Burn-Rate & Path to Cash-Flow Positive

So you have a fairly consistent understanding of your gross margins on the average sale, and how much cash you'll have left to contribute to your fixed costs and operating overhead. That's step #1. Now it's time for a fixed cost analysis. How much do you "burn" every month whether you make a sale or not? What essential bills and payroll must always be covered in a 30-day cycle? And what's your total fixed cost structure in the course of a year? Taking these two sets of numbers into account (contribution margins and fixed costs) you will very quickly determine how much cash you're losing on a monthly basis, how much revenue it will take to stop the cash drain, and the working capital reserves you'll have to set aside in the meantime before you become "cash-flow positive." In a nutshell, you need to understand:

- What's your total monthly and yearly "burn" – your non-negotiable fixed costs?
- More specifically, how much in payroll has to be available on every pay-day?
- How much monthly revenue do you need to reach "cash-flow positive" operations, where your company can self-generate enough cash to run operations and pay staff without dipping into reserves?
- How many individual sales do you need to make that monthly revenue target?
- What percentage of the overall market does this represent. And Is this easily attainable/sustainable?

- How many of your client-prospects will represent a source of "recurring revenue" (e.g. a SaaS subscription model) from which you can build a healthy cash position? Or are you generating a new sale from scratch every time with no guarantee of up-selling, renewals, or recurring income (e.g. consumer goods).
- How much working capital do you need to cover fixed costs until you reach "break-even?"

These questions will take some time to research. But the final results should be simple, clear, and easy to relay:

1. Monthly "Burn-Rate"
2. Recurring Revenue Required to be Cash-Flow-Positive
3. The Funding You Need to Reach Those Revenues… or "Lift-off."

Remember - smart, experienced investors know the most fundamental milestone is "lift-off." They want you to be frank and direct about your real, upfront cash requirements at the early stage. Most investors will oftentimes consider an additional cash injection to achieve ***new*** target objectives – such sales acceleration after lift-off, or operational scalability to handle a growing volume of business. Those objectives represent a positive sign of growth. But rarely will you see a happy face in the room when you come back for more money for the sole purpose of treading water. Burn rates and break-even metrics are at the core of this discussion.

Accelerator Plan to Scalable Growth (The Multiplier Effect)

So now investors understand the economics required to get your venture on its own two-feet. But the final phase of your Money Model that will dictate whether you close your target investor pertains to your "accelerator plan." Achieving cash-flow positive operations means stability. But you ultimately have to demonstrate the potential for scale and accelerated growth. And to do this, you need to speak to some sort of catalyst that will trigger a multiplier effect on your business. This can come in any number of forms. But, again, you want to be sure you can speak to it plainly, succinctly, and verifiably.

- Do you have an innovation and competitive advantage that clearly puts you ahead of your next nearest competitor? And is that position well-protected for an extended timeframe?
- Are you disruptive in a way that will quickly prompt a sizable portion of the market to abandon convention?
- Have you negotiated a strategic partnership that gains you instant access to a sizable client base?
- Are you co-promoting with an established brand that wins you instant exposure and credibility?
- Has recent legislation been passed that now mandates the adoption of your type of solution?
- Have you secured exclusive selling rights in a particularly lucrative market?
- Have you demonstrated through some pilot activity that you generate a rapid degree of viral adoption and consumer "stickiness?"

The scenarios are numerous and varied. And they are not necessarily quantifiable in themselves. But they provide a credible rationale for why an investor can expect to see an acceleration in sales and growth in revenue during a relatively short timeframe. And it is the basis for why an investor would be willing to provide additional funding through an aggressive growth cycle.

Baseline economics. Break-even thresholds. Triggers for scalable growth. These are the core building blocks of a compelling Money Model. They need to be well understood, and well-communicated. You must be able to speak to them simply, succinctly, without jargon, and without spreadsheets.

Limit yourself to a rough sketch on the back of a napkin. That way you'll have both your 30-second elevator pitch and the essentials of your Money Model dedicated to memory for quick, compelling reference.

Good luck! And let us know how we can help. Contact www.canadastartup.com for your mission critical needs.

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