Essential Metrics for Startups (Part 2)

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It's good to be the best today. But what about tomorrow?

You may be the best at what we are doing today, but that doesn't mean that you should stop planning for the future. With a few frameworks and some clever metrics, you can ensure that your firm continues to be as strong tomorrow as it is today by making accurate and sensible projections of your future growth

Understanding Deal Flow

- These metrics are useful in estimating the number of customers/deals you can expect to acquire in the future
- These are the building blocks for your revenue projections

- **Includes:**
  - Average Sales Cycle
  - Average Deal Size
  - Total Contract Value

Revenue Projection

- These metrics are useful in estimating your future revenue
- Projections may not hold true, but when done logically and systematically, it becomes a valuable tool for benchmark

- **Includes:**
  - Weighted Revenue Method
  - Revenue Run Rate

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Understanding Deal Flow: Average Sales Cycle

Definition

- The Average Sales Cycle (ASC) is the time it takes for a prospective client to close on the deal after entering your sales pipeline.
- It is important to track how long it takes for leads to become customers as it is a key part in building your revenue projections

$$\text{Average Sales Cycle} = \frac{\text{Total number of days during the period}}{\text{Total number of deals closed/customers acquired}}$$

What affects ASC?

- **Pricing Strategy**
  - Expensive services and products generally take more time to sell, therefore you would have a longer than average ASC
- **Different Markets**
  - When entering a new market, you would need to spend a significant amount of time to educate your prospects, hence resulting in a longer ASC
- **Product complexity and Target audience**
  - With simpler products meant for mass market usage, you're most likely dealing with a single decision maker, hence a shorter ASC

Understanding Deal Flow: Average Deal Size

Definition

- The Average Deal Size (ADS) is a metric that indicates the average amount of cash a company receives per deal/customer it closes/acquires.
- It is generally used as a key performance indicator and is calculated either monthly or quarterly

$$\text{Average Deal Size} = \frac{\text{Sum of all the cash received from deals/customers this month or quarter}}{\text{Number of deals closed/customers acquired}}$$

How to utilize ADS and ASC together?

- Start off by tabulating the data needed to calculate the ADS for the period
- Estimate the number of deals you can expect to have in the following period
  - You can use the Average Sales Cycle figure to make an estimation
    - *If your ASC is 3 days during this month, you had an average of 10 deals this month*
    - *If you expect sales to pick up due to strong consumer demand, you can reasonably guess that you will have 12 deals next month*
- Multiply ADS with the estimated number of deals next month to derive the projected revenue

Understanding Deal Flow: Total Contract Value

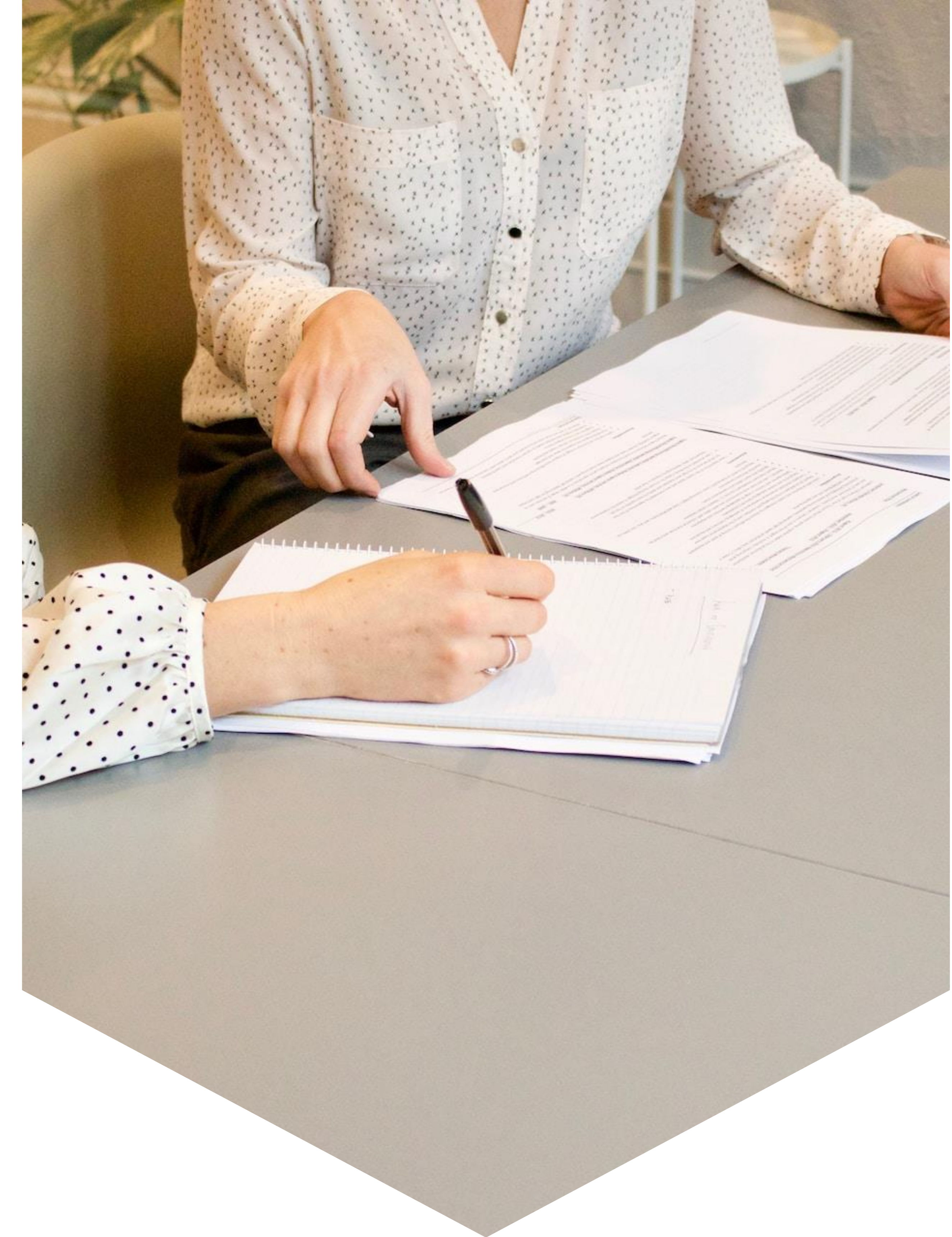
Definition

- The Total Contract Value (TCV) is the overall value of an agreement with a customer
- This includes the expected revenue over the life of the contract along with one-time fees

Total Contract Value	=	Annual Recurring Revenue[1]	✖	Length of contract	➕	One time fees

How to utilize TCV?

- TCV is a helpful metric to understand the amount of money you can expect to earn from a particular contract
- It can serve as a useful benchmark in projecting the size of future deal flows and for estimating the growth in the size of your deals
  - This is especially applicable if you specialize in providing tailored/customized services or products



[1,2,3,4] *For more information: Refer to "Essential Growth Metrics for Startups" by Castellum Capital at https://shorturl.at/sKTZ2*

Revenue Projection: Revenue Run Rate

Definition

- The Revenue Run Rate (RRR) is a financial metric that allows you to project your current revenue this period (month/quarter) into the future (usually for the year)
- RRR is the one of the simplest methods utilized to project revenue

Revenue Run Rate	=	Total revenue earned during the current period	+	Number of periods in a year

What affects RRR?

- **One-time Sales**
  - RRR overweighs one-time sales heavily. If your business centers primarily on recurring revenue streams, RRR will overestimate your future revenue
- **New product release**
  - Normally, sales would increase and then decrease when you release a new feature or product into the market. Forecasted revenue will thus be inaccurate
- **Contract renewals**
  - If your business centers itself on recurring revenue streams, there may be periods where many contracts are ending. RRR does not account for this

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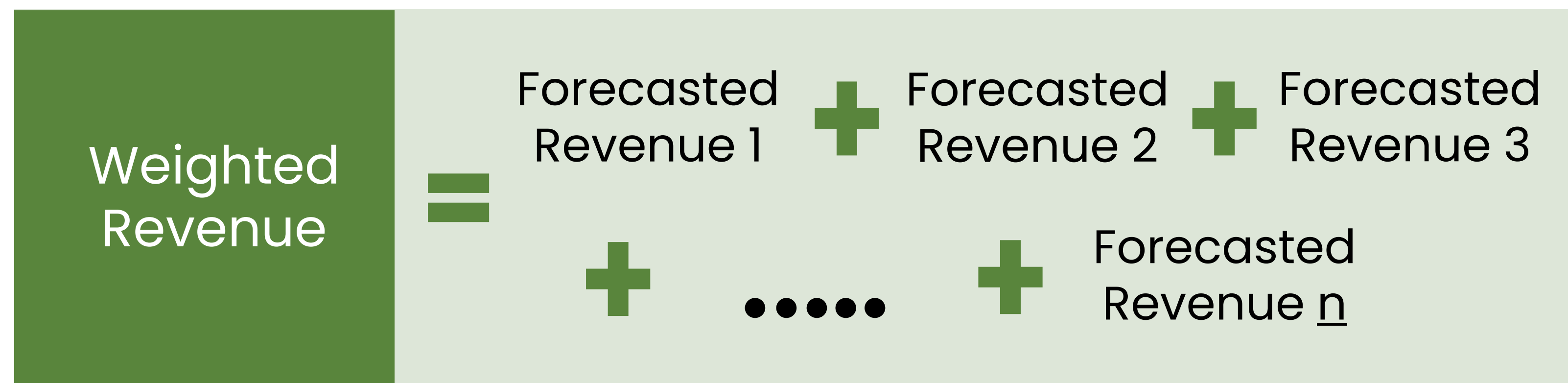
Revenue Projection: Weighted Revenue Method

Definition

- The Weighted Revenue Method (WRM) is used to estimate revenue by assessing the deals in the sales pipeline and their chances of closing
- More specifically, it assigns a probability percentage of success to each deal as not every opportunity ends in a sale.



Refining WRM

- To make your revenue projection more grounded, it is always wise to adopt a systematic approach when estimating the probability of closing
- For example, you can assign certain percentages to each stage of the sales pipeline as you attempt to close the deal with the client
  - Lost opportunity (0%)
  - Prospecting (10%)
  - Lead qualification (25%)
  - Trial (50%)
  - Proposal (60%)
  - Negotiations (75%)
  - Closed Deal (100%)
- As observed, the further along the sales pipeline you go, the probability of the firm closing the deal increases
- Multiply the percentage assigned to the stage of the sales pipeline with the deal value to derive the forecasted revenue

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