Show Me The Money

Revenue and Expenses

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Three Types of Financial Documents

• Income Statement (P&L)
  – Shows Performance Over a Period of Time
    • One Year / One Month
    • Summary of Income and Expenses

• Balance Sheet
  – Summarizes a company’s assets, liabilities, and shareholder equity at a point in time

• Cash Flow Statement
  – Shows cash generated and used over a period of time
  – What’s in the cigar box
  – Startup ‘Burn Rate’ (Cash out/mo. – Revenue in/mo.)
Income Statement (P&L)

Revenue (Price/Unit * Number of Units)
Minus
Cost of Goods Sold
  * Purchases
    Materials
  * Labor Costs
    Hourly + Benefits
    Executive
= Gross Margin
Minus
  * Research & Development
  * Sales & Marketing
  * Administrative Expenses
    Insurance
    Rent
    Equipment Leases
  * Depreciation & Amortization
= Earnings Before Interest & Taxes (EBIT)
Minus
  * Interest & Taxes
= Net Income (ROS)
# Statement of Income

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>G</th>
<th>H</th>
<th>I</th>
<th>J</th>
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<td>Year Ended December 31</td>
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<td>Cost of goods sold</td>
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<td>8</td>
<td>Gross Profit*</td>
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<td>9</td>
<td>Selling, general and administrative expense (SG&amp;A)</td>
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<td></td>
<td></td>
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<tr>
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<td>Research and Development</td>
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<tr>
<td>11</td>
<td>Earnings before Interest, Taxes, Depreciation &amp; Amortization (EBITDA)</td>
<td>$10,000.00</td>
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<td></td>
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<tr>
<td>12</td>
<td>Depreciation and Amortization</td>
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<td>Earnings before Interest &amp; Taxes (EBIT)</td>
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<tr>
<td>14</td>
<td>Interest Expense</td>
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<tr>
<td>15</td>
<td>Income Tax Expense</td>
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<tr>
<td>16</td>
<td>Net Income</td>
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<td></td>
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<tr>
<td>18</td>
<td>Basic weighted average shares outstanding</td>
<td>500.00</td>
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<td></td>
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<tr>
<td>19</td>
<td>Basic Earnings per Share (EPS)</td>
<td>$10.00</td>
<td></td>
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</table>
Apply to Business Model

Key Activities

Make or Buy?

Key Partners
Complementary Assets
Supplier
Power

Key Resources
Cost & Availability

Value Proposition
What Value Proposition To Which Customers

Customer Relationships
Cost to
- Acquire?
- Retain?

Channels
How Powerful?

To Which Customers Do You Provide More Value?

Cost Structure
Cost of Labor /Materials

Pricing Value

Revenue Stream
Profit
Simple Cash Flow/Period of Time

- Definition
  - Net Revenue Generated
  - Change in Investment
    - Changes in Inventory
    - Changes in Receivables
    - Changes in Fixed Investments
  - Cash Flow

Think Simple: Your Business Cigar Box
**Burn rate** is a synonymous term for negative **cash flow**. It is a measure for how fast a company will use up its shareholder capital. If the shareholder capital is exhausted, the company will either have to start making a profit, find additional funding, or close down.

**Burn Rate Example:**
Investor Provides $200,000
Cash Flow = ($50,000 per month) \[\text{Burn Rate}\]
   it will take 4 months for the company to run out of cash.
How To Reduce Burn Rate?

• Increase Revenue
• Reduce Payroll
• Reduce / Defer Other Expenses
• Ditch Unprofitable Revenue Streams
• Pay Bills Slower
• Hold Off Major Purchases / Investments
• Raise Additional Investment Funds
Focus on Revenue / Pricing
Startup Revenue Issues

• What are customer paying for?
  – What value are you providing to who?

• How do customers pay today
  – Nature of revenue stream

• How will you package your product?
  – All features at once? – Add-ons?

• How much will customers pay?
Basic Approaches To Pricing

<table>
<thead>
<tr>
<th>Focus</th>
<th>Perspective</th>
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</thead>
<tbody>
<tr>
<td>Cost</td>
<td>Internal</td>
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<tr>
<td></td>
<td>Competitor</td>
</tr>
<tr>
<td></td>
<td>Customer</td>
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<tr>
<td></td>
<td>Market</td>
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<tr>
<td>Value</td>
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<table>
<thead>
<tr>
<th>Reactive</th>
<th>Proactive</th>
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<tr>
<td>Cost Plus</td>
<td>Experience Curve</td>
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<tr>
<td></td>
<td>Value In Use</td>
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<tr>
<td></td>
<td>Perceived Value</td>
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</tbody>
</table>

Which Focus/Perspective Fits YOUR Project?
Determinants of Price

Upper Long-term Price Ceiling → Economic Value in Use

Buyer plus Seller Learning → Perceived Performance

Transaction Price → Buyer vs. Seller Negotiating Power

Lower Long-term Price Floor → Break-Even

Buyer vs. Seller Negotiating Power → Shut-Down
Concepts: Break Even / Shut-Down

- **Cover All Variable Costs**
  - Variable Costs Include:
    - Cost of Materials
    - Direct Labor (Wages of Employees, Payroll Taxes)

- **Cover Fixed Costs**
  - Fixed Costs Include:
    - Insurances (Medical, Casualty)
    - Your Own Salary, Vacation Pay

- **Shut Down: Don’t Cover Even Variable Cost**

- **Break-Even: Cover All Variable + Fixed Costs**
Calculate Breakeven Volume

• Fixed Costs = $2500 / month
  – Rent / Your Salary & Benefits / Utilities
  – Debt Obligations (Loan Repayments)

• Variable Costs / Unit of Sales
  – Material Costs = $2.00
  – Labor Costs = $ 0.50

• Selling Price = $ 5.00

• What is Breakeven Volume?

• Contribution Margin (SP – VC = CM)
Breakeven Analysis

RISK

Breakeven Volume

Unit Volume

Fixed Cost X

Fixed Cost X ++

Contribution Margin $$

CM %

$$
Using These Concepts . . .

• Risk
  – The higher the breakeven volume the greater the risk
  – Examine breakeven volume as a percent of total market sales (i.e., market share)

• Sustainability (especially not-for-profits)
  – If you neglect to include insurance, retirement, vacation etc. in fixed costs – you will burn out!

• This is you monthly ‘nut’
Determinants of Price

Upper Long-term Price Ceiling → Economic Value in Use

Buyer plus Seller Learning

Perceived Performance

Transaction Price

Buyer vs. Seller Negotiating Power

Break-Even

Lower Long-term Price Floor

Shut-Down
Economic Value-in-Use

The **full cost** of obtaining the same **level of benefits** from a product and/or set of services in the **next best alternative** manner.

This will be different for:

- Different Customers
- Different Market Segments
- At Different Times
Understand Value-In-Use

Examples:

Airline Tickets (Business vs. Tourist)
  Price Differentiator: Saturday Stay-Over

Wide-Sheet Aluminum
  Alcoa: Sales to Airframe Industry

UML IP
  NanoGel
Beware of Alternatives

The Wizard of Id

How much for a German Shepherd?
Five hundred dollars.

How much for a "Beware of Dog" sign?
One dollar and ninety-eight cents.

I'll take the sign.
Examples and Calculation

New O-Ring Invented (Kelrez Gasket)

Current O-Ring

200 machines

Replace every 2 months (6x/yr)

Current Cost @$5 each

Yearly Cost = 200 * 6 * $5 = $6,000

New O-Ring Replaced every 4 months = 3x/yr

What is Value (Price) in Use of New O-Ring?
Calculation

Variable:

- 200 machines
- 6x per year replace
- $5 each

Yearly Cost = 200 * 6 * $5 = $6,000
New O-Ring = 200 * 3 * $X = $6,000
Value-in-Use Pricing . . . Finding Ways To Price Differentiate

Basic Concept: What Is Value of Your Offering Relative To This Customers Next Best Alternative

Process: Thoroughly understand the cost and benefit structure of your customer and their trade-off options, now and in future.

Don’t Ignore “Do It Yourself”
Exercise

• What is YOUR value-in-use?
• What problem are you solving?
• How is the customer/client solving that problem today?
• How can you solve the problem better?
• How can you solve the problem cheaper?
Determinants of Price

Upper Long-term Price Ceiling → Economic Value in Use → Perceived Performance → Break-Even

Perceived Performance

Buyer plus Seller Learning

Buyer vs. Seller Negotiating Power

Lower Long-term Price Floor → Shut-Down
We Can MAP Perceived Performance

• For A Market Segment
  – Common Set Of Needs
  – Similar Importance Of These Needs
• Relative To A Set of Alternatives
• At Point In Time
• From The Customer’s Perspective
What are attributes?

• Think Consumer Reports
• Attributes and Scores
  – Sunscreen
    • SPF
    • Waterproof/Sweatproof
    • Safety of Ingredients
    • Smell
    • Stains
  – Scores: ⑤ ④ ③ ② ①
Different Customer Segments

Rank Importance Weights Differently!

<table>
<thead>
<tr>
<th>Needs</th>
<th>Amateur Camera</th>
<th>Professional Camera</th>
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<tbody>
<tr>
<td>Ease of Use</td>
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<td>Weight</td>
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<td>Size</td>
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<td>Auto Focus</td>
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Big Idea: Customers Buy Your For Your Strengths
Accelerator Exercise

List The Top 4 Attributes of Your Product or Service?

1.______________________
2.______________________
3.______________________
4.______________________

You Learned This Through Customer Interviews!
Issue:

Which of these attributes are more important, which are less important to your customer/client?
Price - Performance Measurement

3. Rank Your Performance Relative To The Competition (e.g., 1-7)
- Anchor The Scale for Each Benefit (e.g., What is 1? 4? 7?)

<table>
<thead>
<tr>
<th>User Benefits</th>
<th>Relative Weights</th>
<th>Market-Based Competitive Ratings</th>
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<td>Comp A</td>
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4. Do Relative Weight * Rating To Get Performance Score
<table>
<thead>
<tr>
<th>Attribute</th>
<th>Importance</th>
<th>Your Score</th>
<th>1st Competitor</th>
<th>2nd Competitor</th>
<th>3rd Competitor</th>
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<td>6</td>
<td>4</td>
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<td>Totals</td>
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<td>A/D</td>
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<td>132%</td>
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Perceived Value Pricing
Relative Value Drives Market Share

Low Value
Sales Lag
Inventory Builds
Discount Price

High Value
Sales Build
Stockouts
Shortage Pricing

Discount Position

Premium Position

Equal Value

Price ($)

Low

Perceived Performance

Low

High
Negotiating Power
Price Elasticity

% Change in Quantity / % Change in Price
Determinants of Elasticity

• Value of Unique Attributes to Buyer
  – Grey Poupon vs Heinz

• Limited Awareness/Access to Substitutes
  – Avon Cosmetics or Resort Restaurants

• Difficulty of Price / Value Comparisons
  – Grocery Store Package Sizes

• Value to Downstream Users
  – Stainmaster Carpets

• End User Benefit Differential
Determinants of Elasticity

- Percent of Budget / $ Size of Expenditure
  - Paper to Newspapers / Car Purchase

- End User Price Sensitivity
  - Steel in Price Sensitive Desks

- Sunk Investment
  - Camera Film / Cross Refills / Green Antifreeze

- Share Cost
  - Company Provided Health Insurance

- Inventory Effect
  - Purchase Now in Anticipation of Higher Prices
It's easier to go down than up.
Revenue Streams

• Asset Sale (Buy a Car)
• Usage Fee (Cell Phone)
• Subscription (Netflix)
• Renting – Temporary Access (Car Rental)
• Licensing IP (Software)
• Intermediation Fee (Real Estate Broker)
• Advertising (Google)
• Data Sales
• Referral Sales
• Consulting
Questions?