

Show Me The Money

Revenue and Expenses

Valerie Kijewski, Ph.D.
University of Massachusetts Lowell

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)

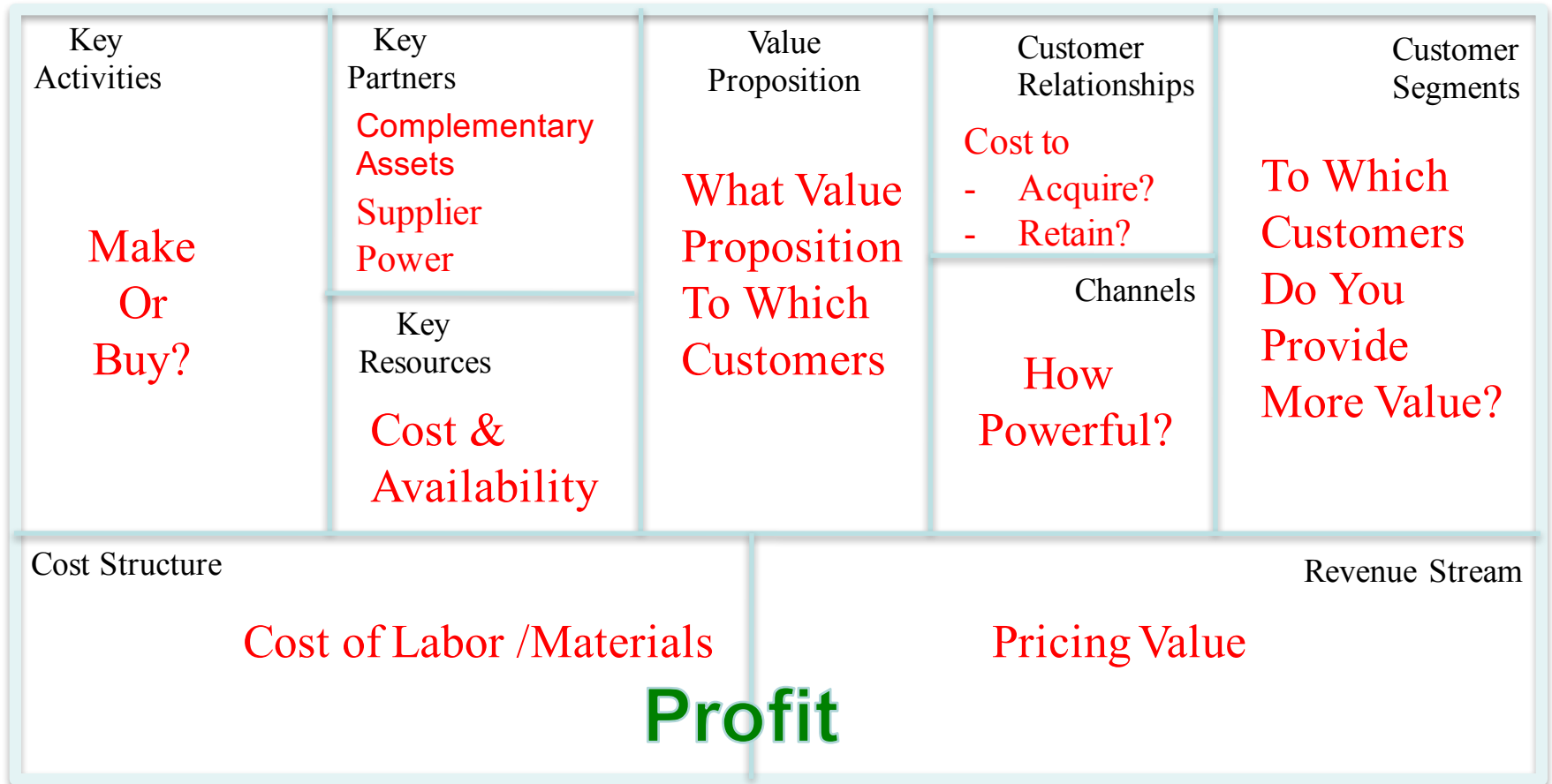
Minus

* Interest & Taxes

= Net Income (ROS)

	A	B	C	D	E	G	H	I	J	K
1	Statement of Income									
2										
3									Year Ended December 31	
4									2009	
5										
6	Revenue								\$35,000.00	
7	Cost of goods sold								\$15,000.00	
8	Gross Profit*								\$20,000.00	
9	Selling, general and administrative expense (SG&A)								\$5,000.00	
10	Research and Development								\$5,000.00	
11	Earnings before Interest, Taxes, Depreciation & Amortization (EBITDA)								\$10,000.00	
12	Depreciation and Amortization								\$3,000.00	
13	Earnings before Interest & Taxes (EBIT)								\$7,000.00	
14	Interest Expense								\$1,000.00	
15	Income Tax Expense								\$1,000.00	
16	Net Income								\$5,000.00	
17										
18	Basic weighted average shares outstanding								500.00	
19	Basic Earnings per Share (EPS)								\$10.00	

Apply to Business Model



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)** [Burn Rate]

it will take 4 months for the company to run out of cash.

How To Reduce Burn Rate?

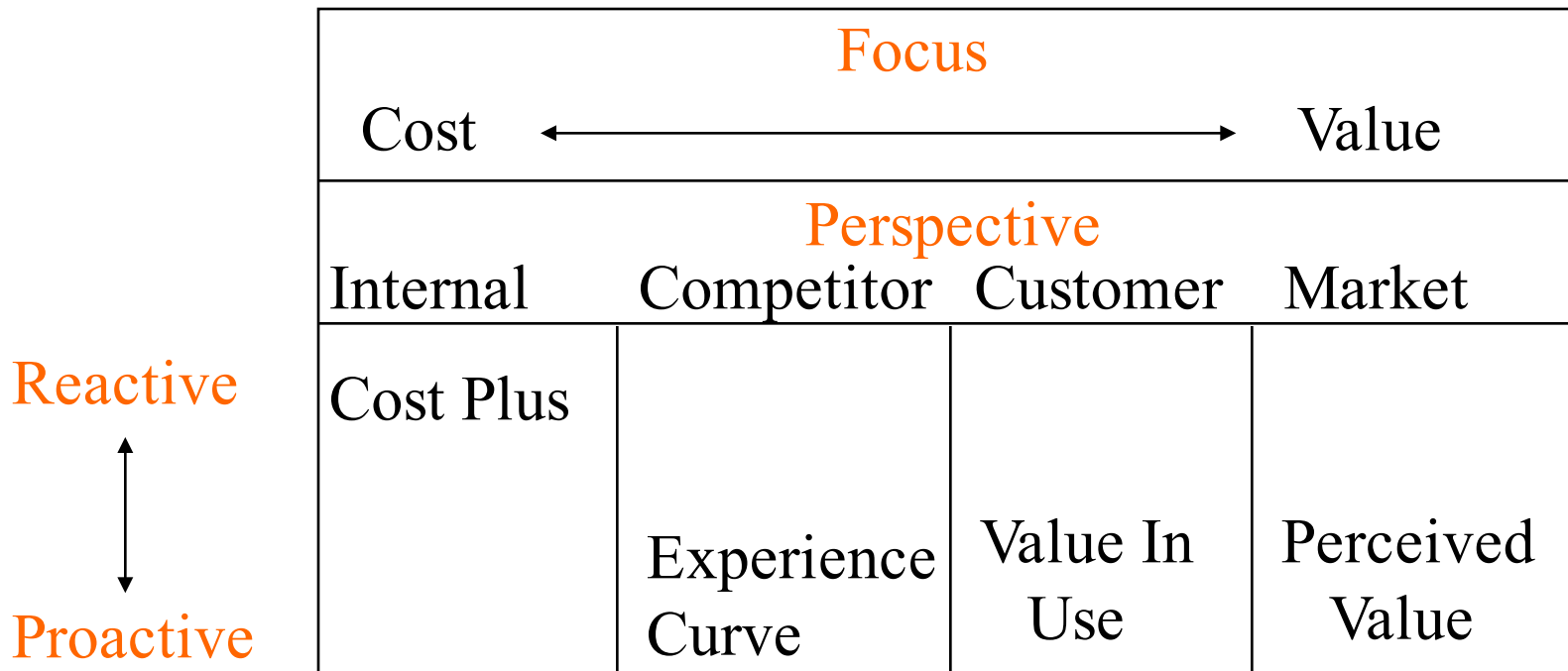
- Increase Revenue
- Reduce Payroll
- Reduce / Defer Other Expenses
- Ditch Unprofitable Revenue Streams
- Pay Bills Slower
- Hold Off Major Purchases / Investments
- Raise Additional Investment Funds

Focus on Revenue / Pricing

Startup Revenue Issues

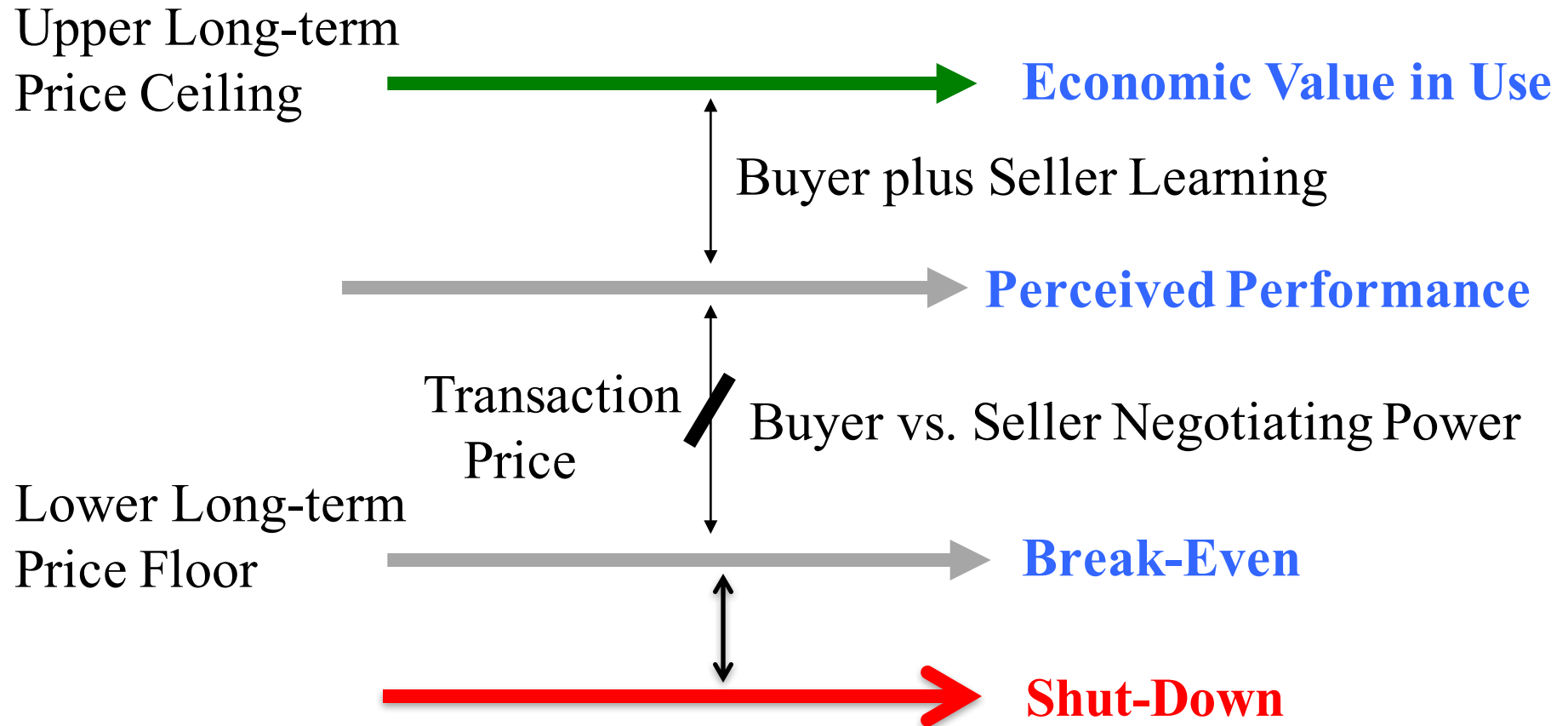
- What are customer paying for?
 - What value are you providing to who?
- How do customers pay today
 - Nature of revenue stream
- How will you package your product?
 - All features at once? – Add-ons?
- How much will customers pay?

Basic Approaches To Pricing



Which Focus/Perspective Fits YOUR Project?

Determinants of Price



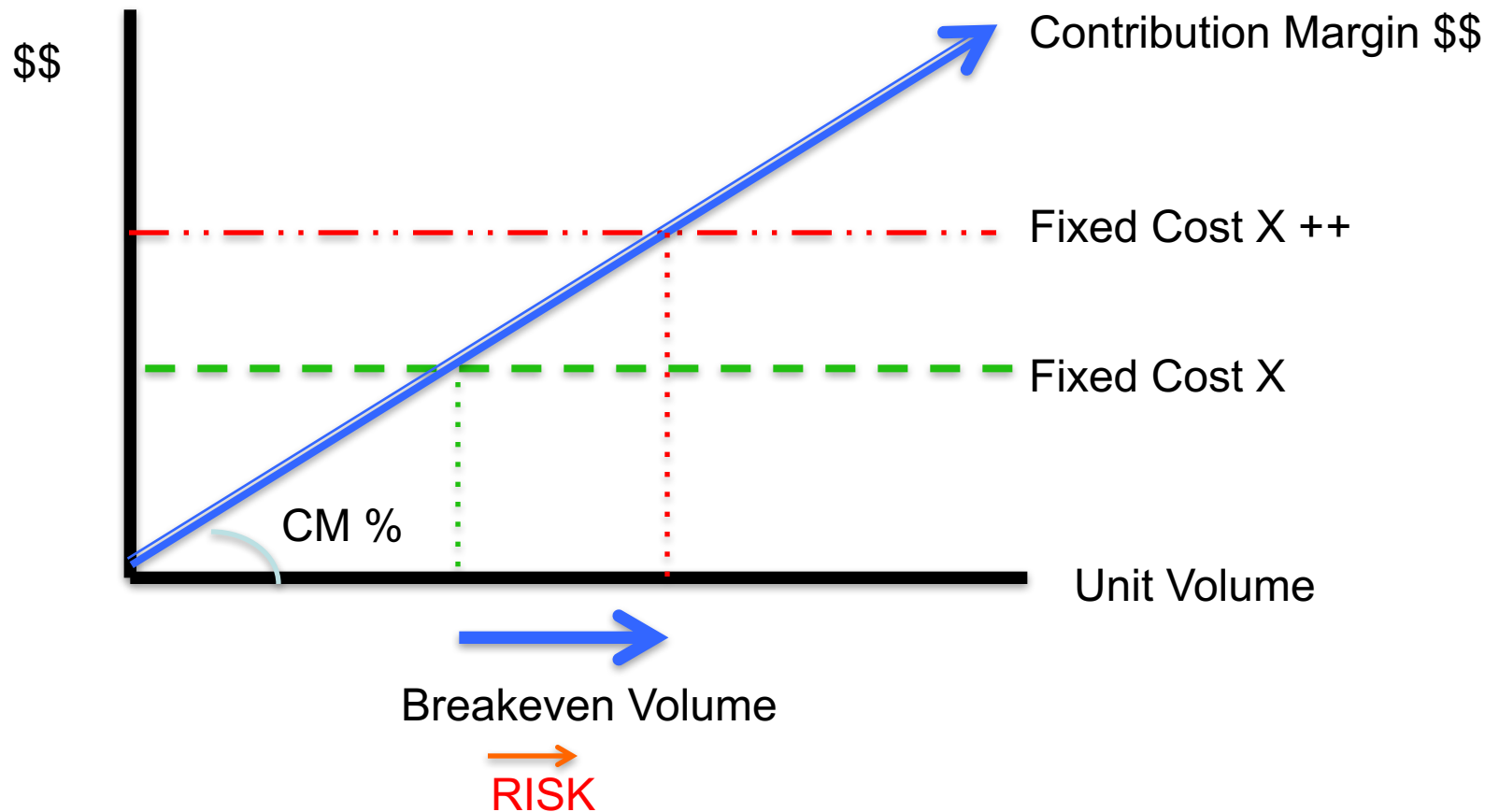
Concepts: Break Even / Shut-Down

- 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 ($SP - VC = CM$)

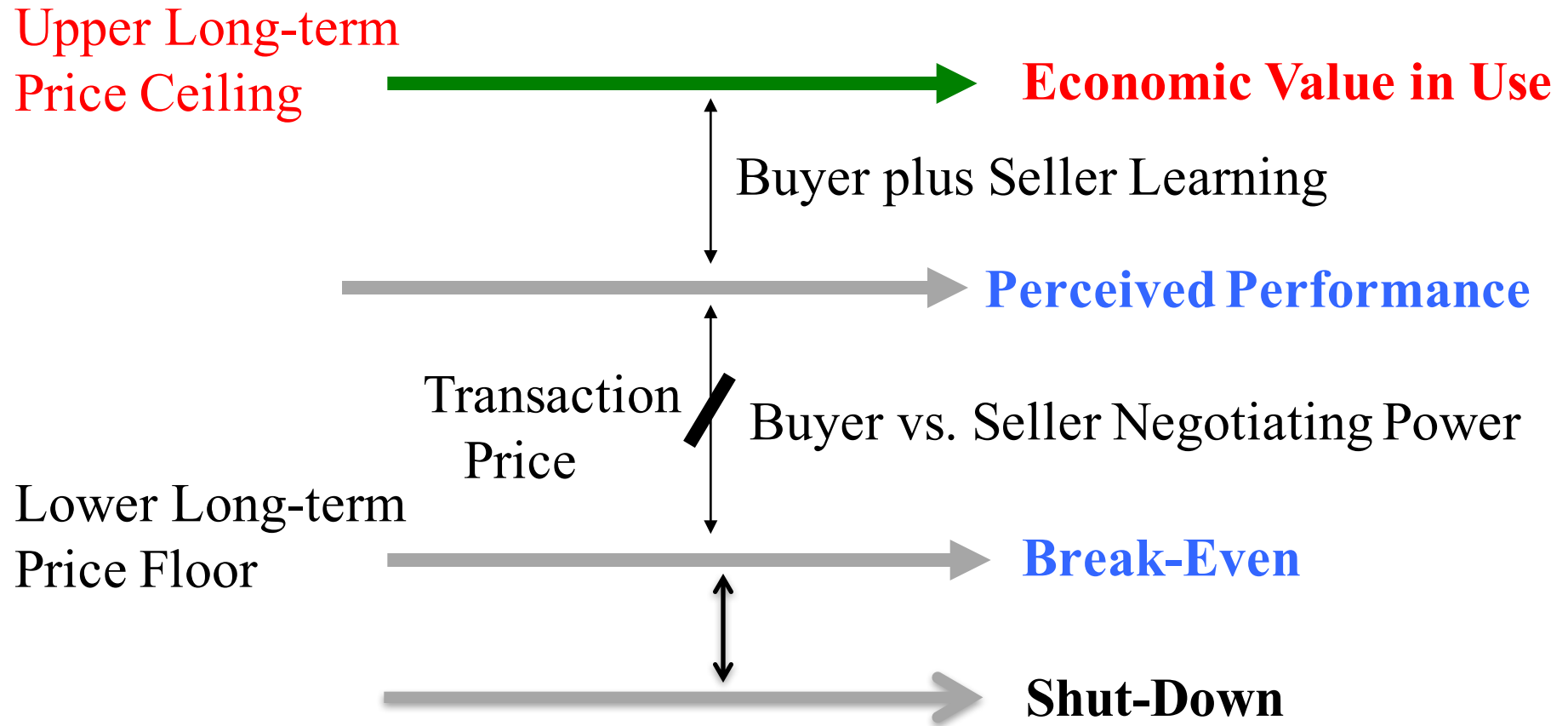
Breakeven Analysis



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



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



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

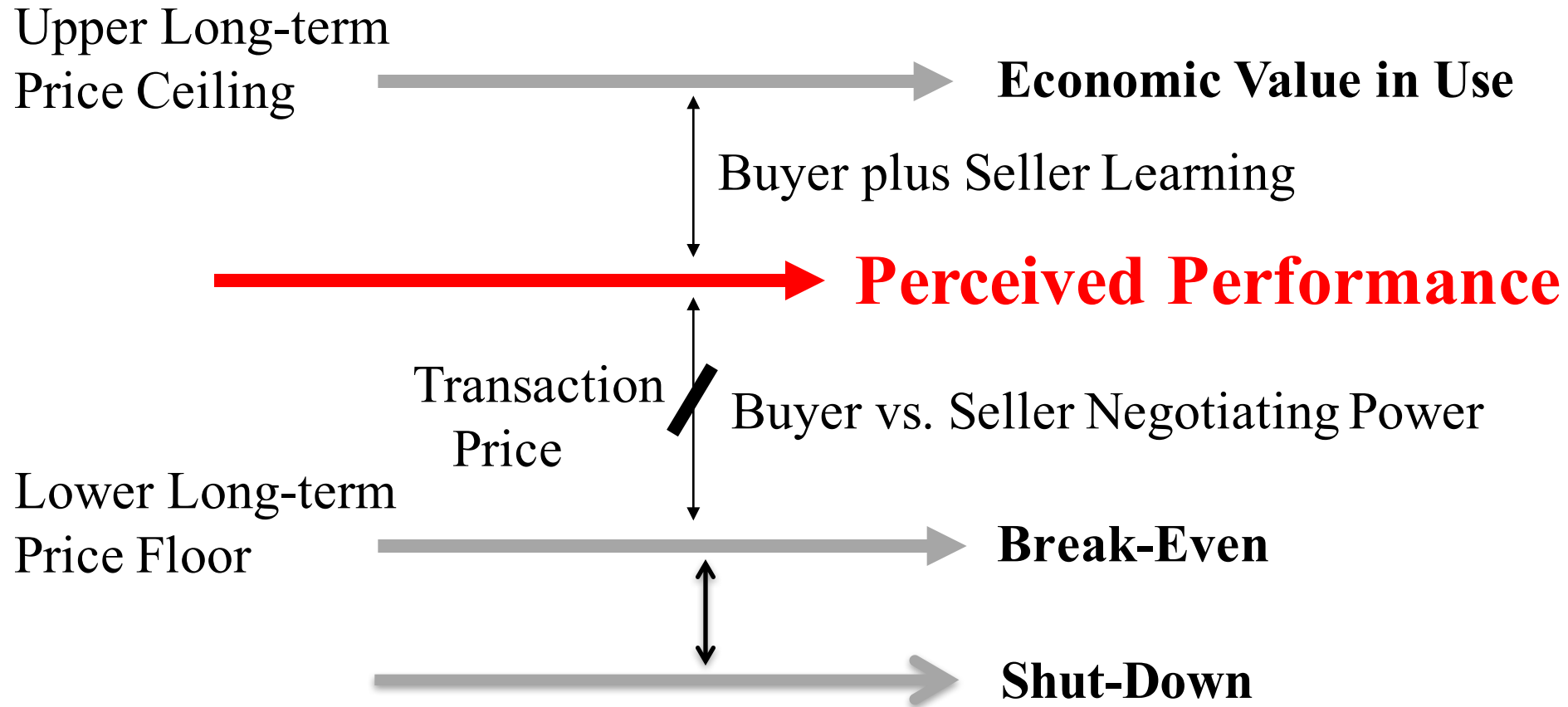
Process: Thoroughly understand the cost and benefit structure of your customer and their trade-off options, now and in future.

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



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!

<u>Needs</u>	<u>Amateur Camera</u>	<u>Professional Camera</u>
Ease of Use		
Weight		
Lens		
Options		
Size		
Auto Focus		

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

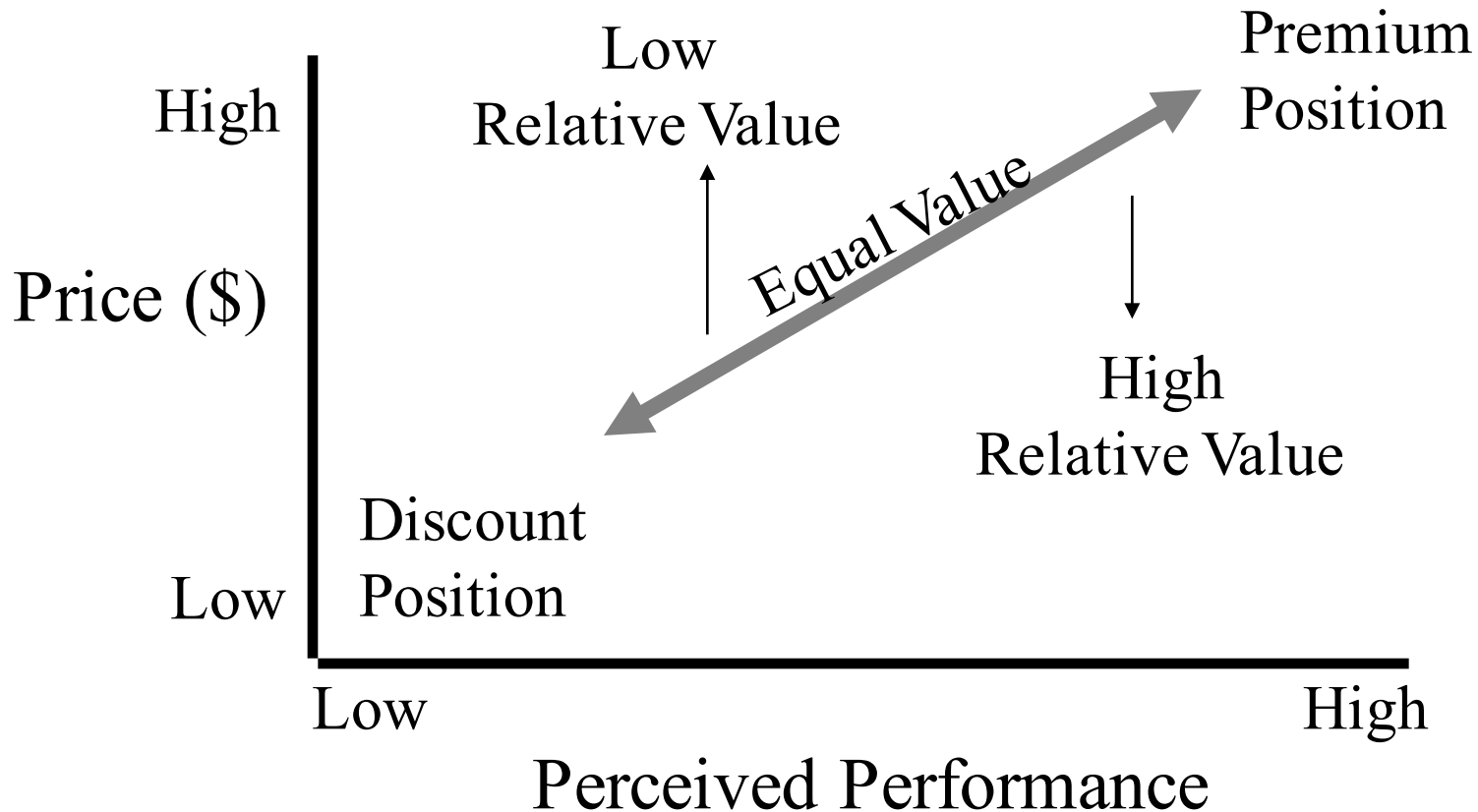
3. Rank Your Performance Relative To The Competition (e.g., 1-7)
- Anchor The Scale for Each Benefit (e.g., What is 1? 4? 7?)

User Benefits	Relative Weights	Market-Based Competitive Ratings			
		Comp A	Comp B	Comp C	Comp n
1.					
2.					
3.					
4.					
5.					

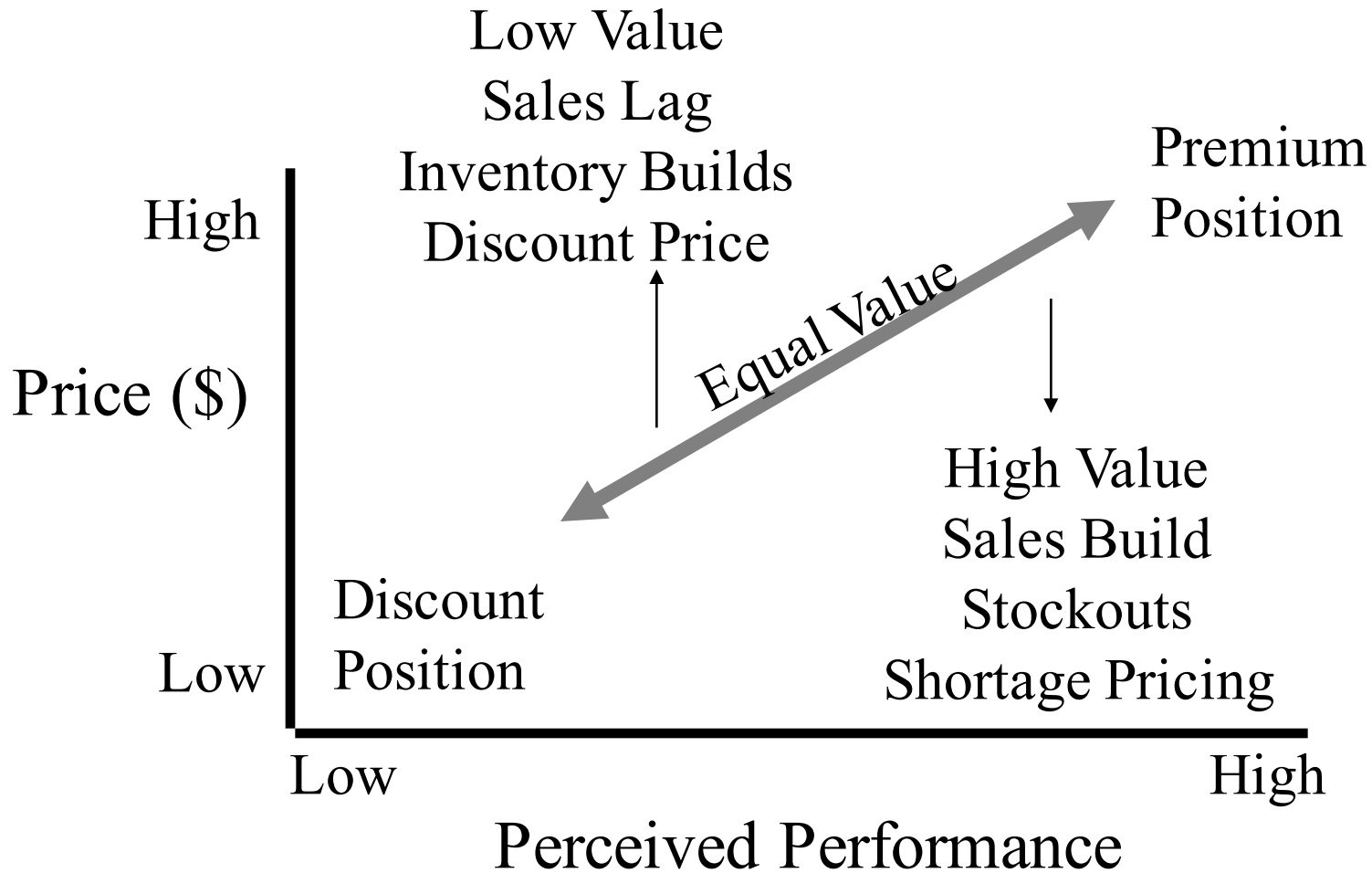
4. Do Relative Weight * Rating To Get Performance Score

Attribute	Importance	Your Score	1st Competitor	2nd Competitor	3rd Competitor
Reliability	10%	3	6	4	3
Tolerance Levels	40%	6	4	4	3
Parts Availib'ty	20%	4	6	4	5
Service Response	20%	3	3	3	3
Company Image	10%	4	4	3	3
		1x3=.3 .4x6=2.4 .2x4=.8 .2x3=.6 .1x4=.4			
Totals	100%	4.5	4.4	3.7	3.4
	A/B	102%			
	A/C	122%			
	A/D	132%			

Perceived Value Pricing



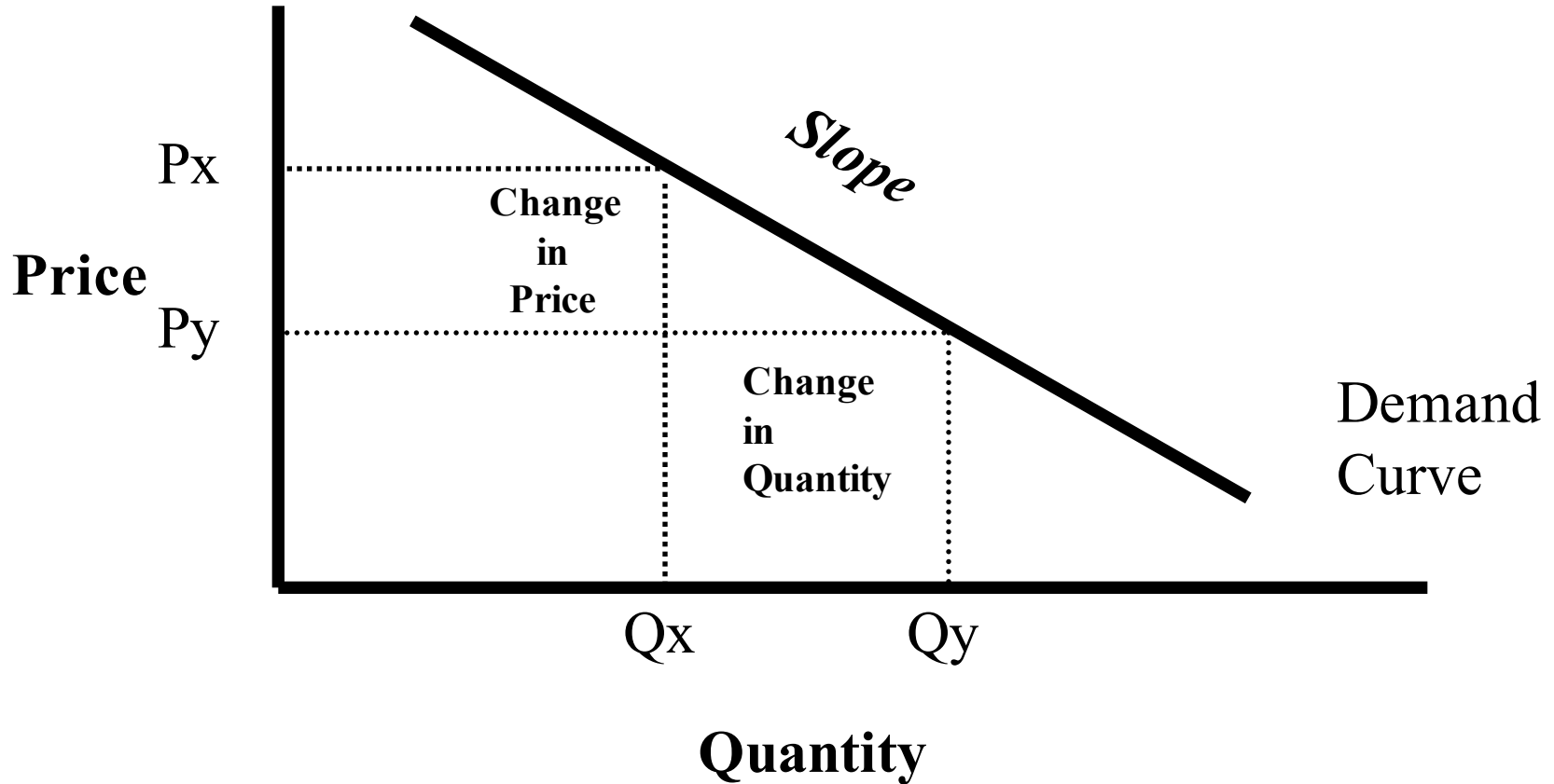
Relative Value Drives Market Share



Negotiating Power

Price Elasticity

% Change in Quantity / % Change in Price



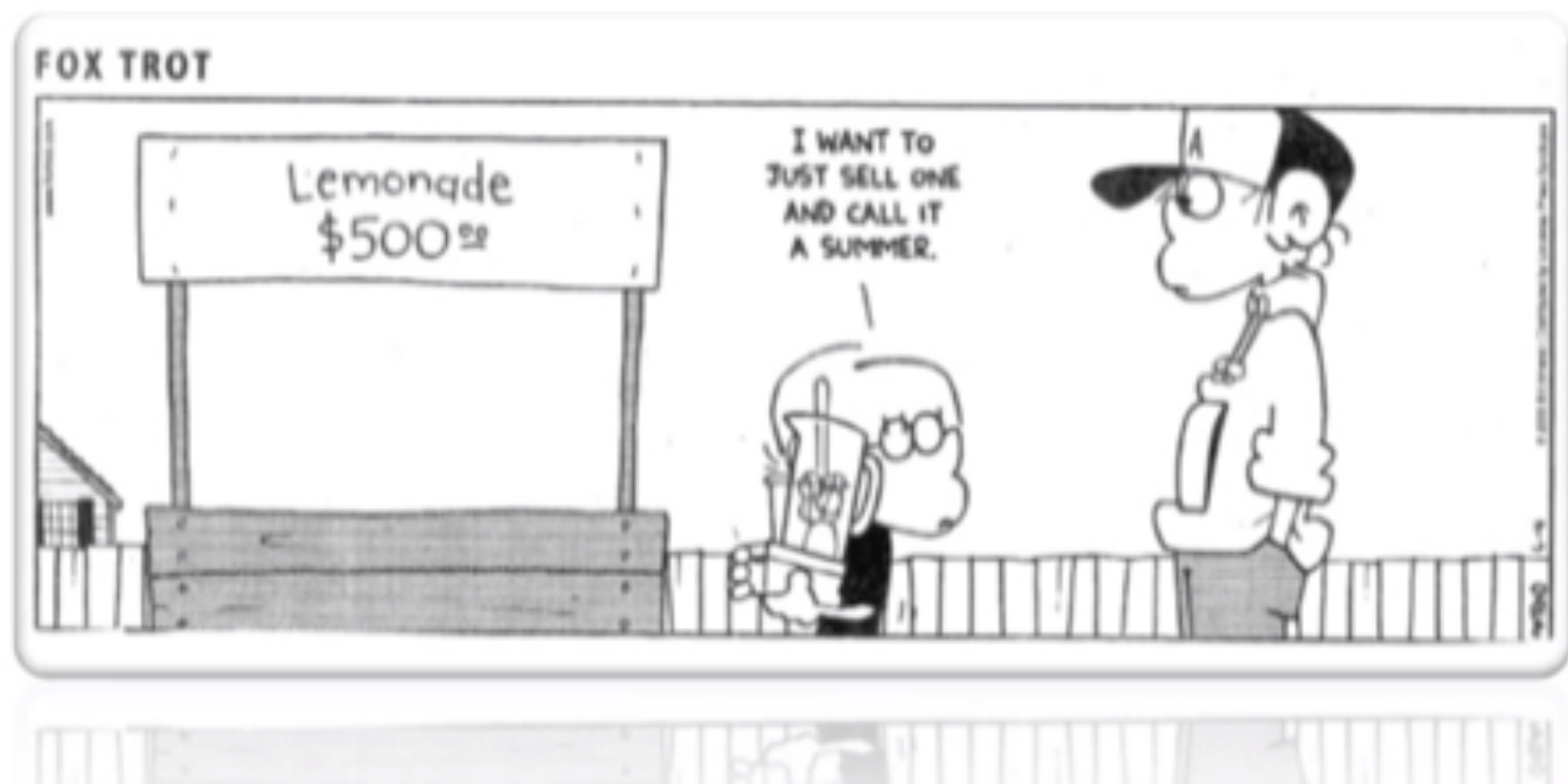
Determinants of Elasticity

- 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

Its 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?