## How do you measure the success of your startup? V2

**What is the purpose of this article?**
1) The focus of this article is on startups where the intent is to create a large long-lasting company.
2) The startup may have equity investors (other than friends and family) or it may be bootstrapped.

This article is intended to enable discussion. The article does not provide legal or financial advice.

**What are the critical learnings in this article?**
The measures of success depend upon who in your company's ecosystem is doing the measuring.

Startup founders can measure success from three perspectives:
1) The customers' perceptions;
2) Engagement with the customer; and
3) Internal measures, especially the monthly cash flow forecast and tracking,

**What are the two types of founders?**
#1 The startup represents their life's calling. The intent it to create a company they can be with for the rest of their life.
#2 They understand they may have to exist the eventual successful company, due to acquisition or other reasons.

Most equity investors in a startup want to get a return on the capital, which requires someone to buy their investment. This often requires selling the company. IPO's are relatively rare. This can create a misalignment between the founders, who intended to create a long-lasting company, and the equity investors. Some founders retain control of their company by using dual-class shares and/or shareholders agreements.

Buyers may have many reasons to buy a company. E.g. Buyers (or investors) believe in future potential, even when the current situation may appear bleak. The buyer can enable the startup's success. Instagram was less than 2 years old, had zero revenue, and 13 employees. Facebook (now Meta) paid $1 billion U.S. to buy Instagram.

**What is a startup?**
Startups are not building a solution. They are building a tool to learn what solution to build.[1]

The startup is a temporary organization designed to search out a repeatable, scalable, and profitable business with customers who are willing and able to pay to solve their problems and needs.

**What are the possible outcomes for a startup?**
The search for a repeatable, scalable, and profitable business with customers that are willing and able to pay to solve their problems and needs can end three ways:
1) Found a profitable business with major potential for significant scaling
2) Found a profitable business which has little or no potential for significant scaling.
3) Failed to find a profitable business. Company survives due to capital infusions by investors.
4) Failed to find a profitable business. Company fails.
5) Do an IPO
6) Be acquired.

Profit means that life time customer cash profitability exceeds customer acquisitions costs. This implies that in a period of high growth, cash flow may be negative.

There are many types of financial success, including
1) The startup may have "failed" but still be acquired for a large amount of money. E.g. Facebook pad $1 billion for Instagram, which had no revenue and 13 employees.
2) The founders bootstrap the company, with no 3rd party equity investors other than friends and family. E.g. Zoho's founder became a billionaire. The company is family owned.
3) The founders bootstrap the company and then. E.g. Mailchimp was sold to Intuit for $12 billion, 20 years after being founded. It was initially a web design consulting firm.

**Measuring success depends upon who is doing the measuring. E.g.**
1) Founders
2) Employees
3) Customers and users
4) Angel investors
5) Early stage funds
6) Venture Capital
7) Investment Bank
8) Strategic Buyer

**What are the three sets of startup success metrics?**
#1 Customer perceived metrics.
Understanding customer perception means that you have to listen to what the customer tells you. This is NOT your opinion.

*Documented customer problems and needs*
1) What are your customers urgent problems and needs?
2) What would be the value to them if their problems and needs were addressed?

*Documented customer value proposition*
1) The value proposition is based on what current, past, and potential customers think, feel, believe, and perceive. The customers' perception of net value they achieve, which is a combination of the benefits they achieve and their costs of adopting your solution. Their costs are often far higher than what you charge your customers.
2) How does the customer perceive your value proposition, relative to the competition? (And the competition always includes the current situation)

*NPS Net Promoter Score*
1) The NPS (Net Promoter Score) i.e. "Would you recommend our solution to others?" Follow on questions could be: "If so, why? If not, why not?"
2) The appendix will direct you to further information regarding NOS.

*Sean Ellis Product Market Fit test*
You can start measuring NPS once customers start to use your solution, even in the pilot and testing phases.
You ask the question: "How would you feel if you could no longer use our product or service?"
1) Very disappointed?
2) Somewhat disappointed?
3) Not disappointed – it's not really that useful?
4) I no longer use.

At least 40% of your target customers must say "very disappointed". If it's less than 40% you need to reposition/change your product. One approach can be to segment the answers to find a customer segment where the response is above 40%.

You must understand the group above 40%. The 5 questions to ask them are: 1) who are you (demographically) 2) why did they seek out your product/service? 3) how are they using it 4) what is the key benefit 5) why is that benefit important?

*Market Size*
Market size is driven by the number of people who believe: they have a problem, they're willing to pay to solve it, and you're providing a competitively differentiated value proposition.
Market segments will be driven by: different sets of problems and related value proposition (i.e. this is why tiered pricing is needed), geographies, channels, etc.

#2 Your measurements of customer engagement
Non-revenue metrics can include:
1) Website visits – how many, what they look at, how long they spend on your website
2) LinkedIn followers and visits for your company profile
3) Newsletters – how many sign up, click on content
4) Number of incoming calls and emails

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5) Number of meetings and zoom calls
6) Pilots and other paying customers using your solution
7) Letters of intents

Revenue metrics can include:
1) MRR (Monthly Recurring Revenue) from you solutions. This excludes revenue not-related to your solution
2) Customer retention or churn
3) Signed contracts with committed future revenues

#3 Business and Customer Profitability

Profitability is examined from a cash flow perspective, not accounting statements.

Your revenue must exceed the total of: CAC (Customer Acquisition Costs), COGS (Cost of Goods Sold), R&D New Development and G&A (General and Admin).

Your lifetime customer profitability must exceed your CAC. You need to always consider G&A in your profitability analysis.

In a high growth situation, your monthly cash flow may be negative, due to the time lag required for long-term customer profitability to cover CAC.

The foundation is your monthly cash flow forecast, linked to your milestones and assumptions. Your forecast milestones will show the impact of spending on: new product releases, new channels, new partners, CAC, churn, etc. Your tracking will show the actual results.

You must have scenarios, both for revenues and costs. E.g. would you be profitable if stopped investing in major new product development? What if your churn rate turns out to be higher? What if CAC doesn't decrease but increases? Etc.

The appendix provides further information regarding customer and business profitability.

**What are your next steps?**
1) Set up a financial process (including General Ledger) and associated software. The software would ideally support both financial and non-financial metrics.
2) Document your definitions of the different cost components.
3) Create you initial set of assumptions.
4) Start measuring customer perceptions and customer engagement from day 1.
5) Your monthly cash flow forecast and tracking is a critical tool to reduce the odds of running out of cash.

**What further reading should you do?**
Do you understand your customers?
http://koorandassociates.org/understanding-customers/do-you-understand-your-customers/

**Appendix – Customer and Business Profitability**

Your monthly cash flow forecast and tracking.
1) This is done on a cash flow basis, not accounting statements.
2) There are four major cost groupings
   a) CAC
   b) COGS
   c) R&D/Engineering/New Development
   d) G&A
3) Further grouping to consider include: customers (and related costs) by cohort, customer segment, channel, partner
4) The cash flow forecast includes:
   a) Links to major milestones
   b) Scenarios – remember, no-one can accurately forecast the future
   c) Capital infusions.

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**What are the definitions of the metrics?**

CAC includes all the costs to acquire a new customer:
1) Sales
2) Marketing
3) Onboard
4) Related compensation of the people.
5) Overhead associated with the people.
6) Technology to support CAC.
7) Legal expenses associated with sales and marketing

If you have a freemium business model, then all of the costs associated with the “free” service fall into CAC.

What comprises cost of COGS? Everything required to meet the direct needs of current customers. E.g.
1) Customer support people, and software
2) Technology e.g. software, cloud services, communications costs.
3) Bug fix and minor enhancement to the software – after all you do need to retain current existing customers.

What comprises G&A?
1) Payroll administration
2) Recruiting administration
3) Finance
4) IT security
5) Corporate development e.g. M&A
6) CEO salary/benefits
7) Legal expenses (both in house and external), other than those associated with sales contracts

Let’s use QuickBooks to illustrate the concept of the financial metrics.
There is a GL line item for salaries.
Then then there is a class i.e. where does the salary belong? (i.e. QuickBooks class)
1) CAC?
2) Cost of goods sold?
3) R&D/Engineering/New Development?
4) G&A?

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