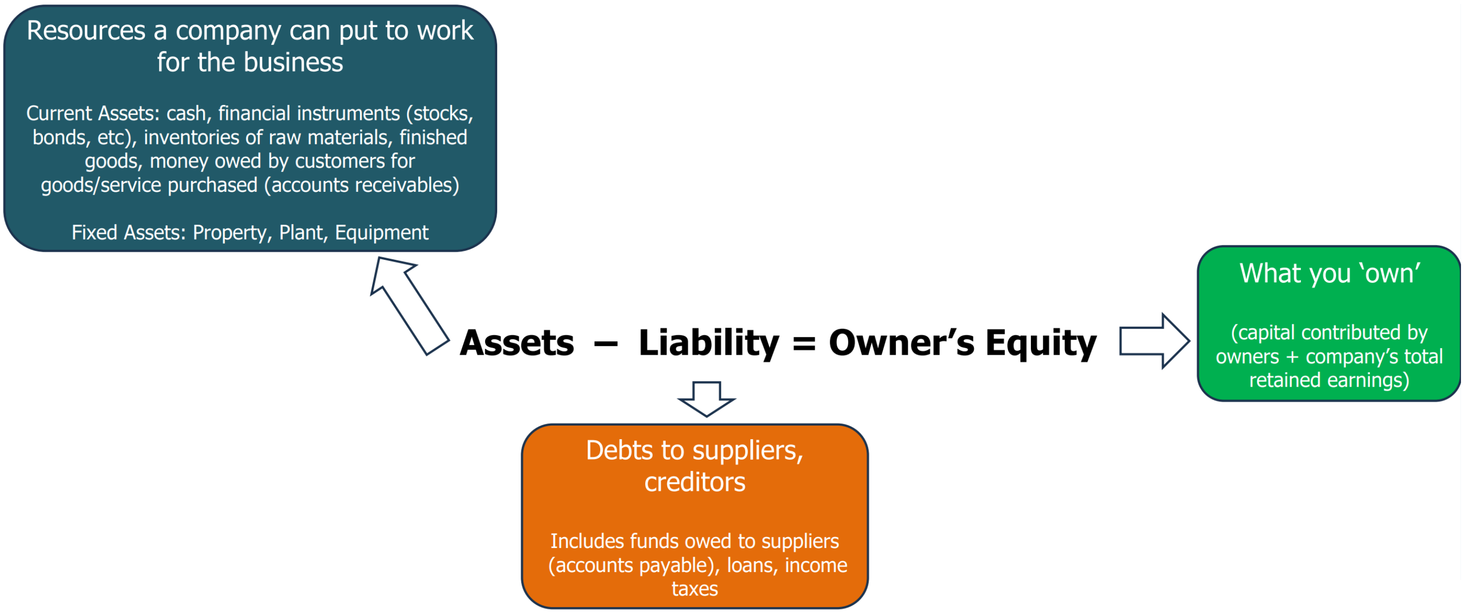
M9, M10 - Finance for Startups

Cost: Money value of resources required to produce something
Price: Money to be paid, in order to get a product / service
Value: The utility of a product or service

Assets - Liability = Owner's Equity



Basic Terms and Relations

Revenue

Amount earned by company before deducting any expenses

Cost of Goods Sold (COGS)

- Direct cost of producing products (including everything like raw materials, manufacturing etc)

Gross Profit

$$GrossProfit = Revenue - COGS$$

Gross Profit Margin

$$\text{Gross Profit Margin} = \left(\frac{\text{Revenue} - \text{COGS}}{\text{Revenue}}\right) \times 100 = \left(\frac{\text{Gross Profit}}{\text{Revenue}}\right) \times 100$$

Operating Expenses

Ongoing costs a business incurs to run its operations (rent, salaries, utilities, marketing, etc; these do not include the cost of producing goods/COGS)

Operating Profit

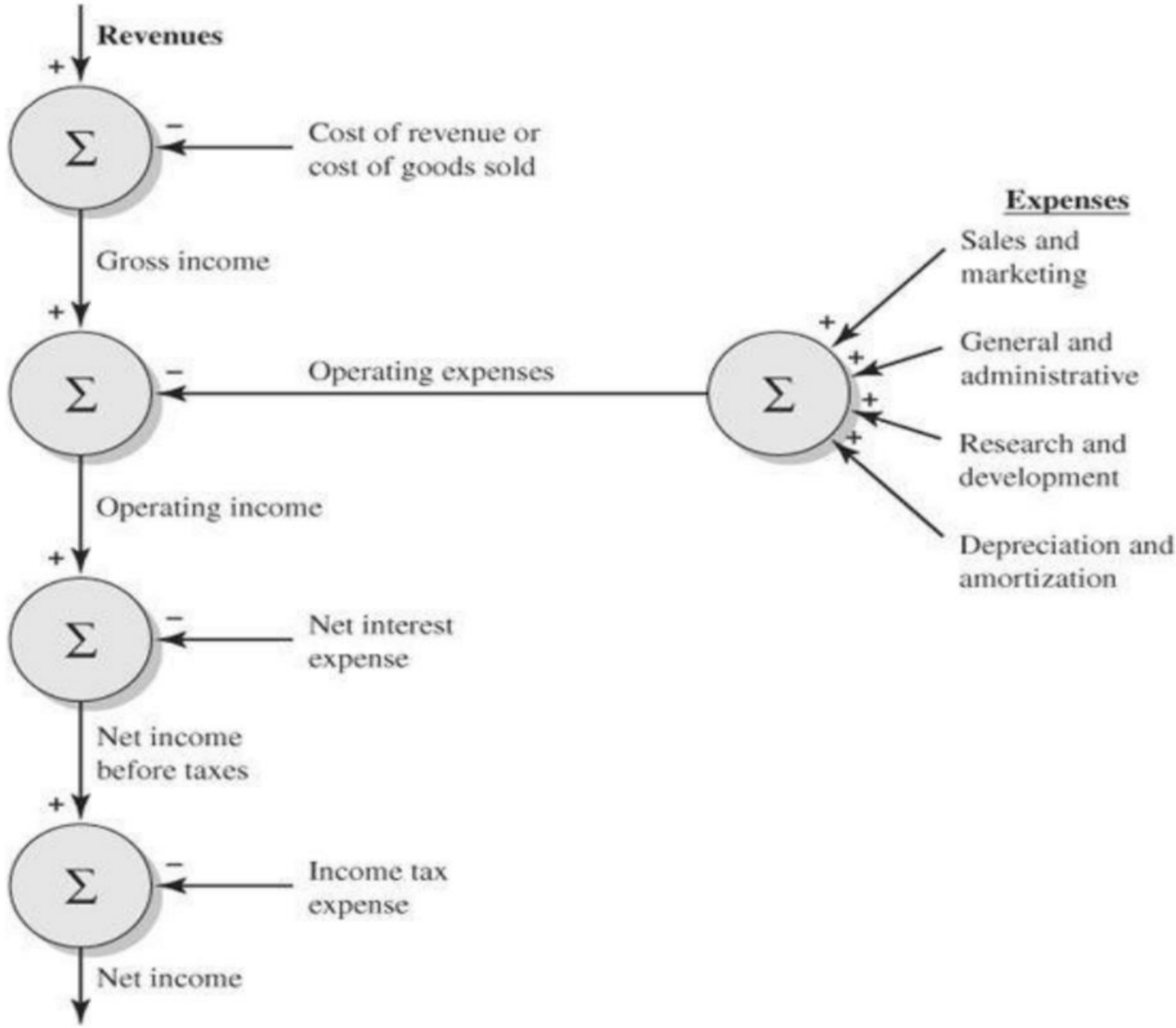
$$\text{Operating Profit} = \text{Gross Profit} - \text{Operating Expenses}$$

Operating Profit Margin

$$\text{Gross Profit Margin} = \left(\frac{\text{Gross Profit} - \text{Operating Expenses}}{\text{Revenue}}\right) \times 100 = \left(\frac{\text{Operating Income}}{\text{Revenue}}\right) \times 100$$

Net Income

$$\text{Net Income} = \text{Operating Profit} - (\text{Taxes, Interest \& Other Charges})$$



Balance Sheet

Financial statement that shows a company’s assets, liabilities, and equity **at a specific time**. It provides a **snapshot of the company’s financial health**

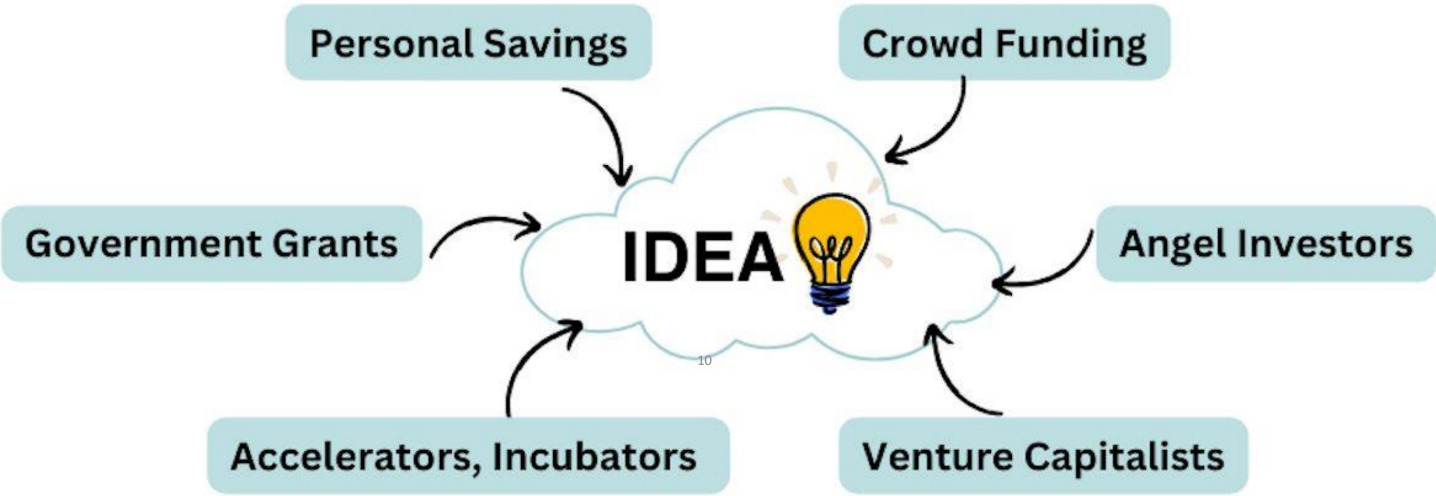
Income Statement

Also known as the Profit and Loss Statement, it shows a company’s revenues, expenses, and profit (or loss) **over a period of time, such as a month or a year**

Cash Flow Statement

Tracks the movement of cash **in/out of a business**; how much cash is available for operations, investing, and financing

Sources for Startup Funding



Bootstrapping/Personal Savings

Many entrepreneurs initially use their personal savings/assets to fund their startup. The self-funding approach allows founders to maintain control/ownership over the business

Crowdfunding

Online campaigns -> enables entrepreneurs to access capital while creating awareness & attracting potential customers

Angels

High net worth individuals who provide capital to startups in exchange for equity or convertible debt. They often invest in startups in the early stages and provide financial support, mentorship, and industry connections.

Venture Capital Firms

- Professional investment firms that provide funding to **startups with high growth potential**
- Typically invest **larger amounts of money in exchange for equity** and often take an **active role** in the company's strategic decisions

Incubators, Accelerators

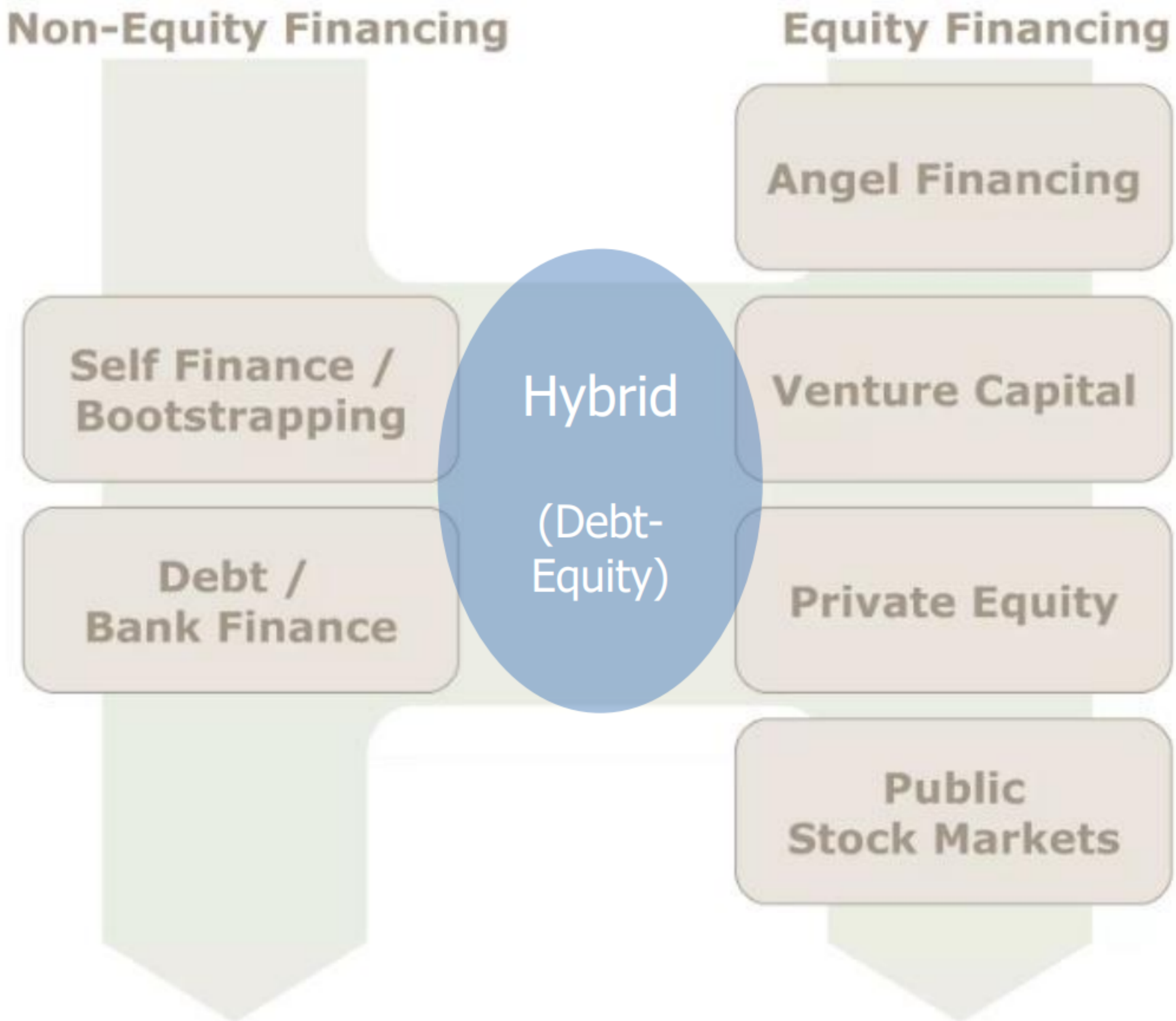
Offer a combination of funding, mentorship, & resources to early-stage companies. They also provide guidance & networking opportunities to help startups grow/succeed

Govt Grants

Many governments provide grants, loans, or subsidies to support startup innovation and entrepreneurship

Convertible Note (CN)

Starts as a loan (debt) but can be converted into equity (ownership shares) under certain conditions



SAFE - Simple Agreement for Future Equity

- Contract allowing startups to raise capital from investors while offering the investors the option to convert their investment into equity in the future
- Quick & easy way for startups to raise capital without having to determine a valuation

Equity

Types

- **Founders' Equity:** Founders initially hold the majority of equity in a startup. They receive equity in exchange for their contribution of intellectual property, ideas, expertise, or other valuable assets.

- **Investor Equity:** To raise funds for growth and development, startups often seek external investment. Investors, such as angel investors or venture capital firms, provide capital in exchange for equity in the company.

- **Employee Equity:** Startups frequently offer equity as part of their compensation packages to attract and retain talented employees.

Terms

- **Vesting:** Ensures that founders, investors, employees earn equity over time/upon achieving certain milestones. Aligns stakeholder interests with startup interests
- **Dilution:** Issuing new shares -> lessening of existing shares' values
- **Exit:** Company acquired/goes public through initial public offering (IPO) -> Cash out

Key Metrics

Customer acquisition cost (CAC, Rs/$)
CAC is the amount of money you need to spend on sales, marketing and related expenses, on average, to acquire a new customer

Lifetime value (LTV, Rs/$)
measure of the net *value* of an average customer to your business over the estimated life of the relationship with your company

CAC to LTV ratio:
The ratio of CAC to LTV is considered to be a golden metric - this is an indicator of the sustainability of a company

Customer retention rate (or Churn, %)
indicates the % of paying customers who remain paying customers during a given period of time (or conversely, churn or attrition is the % of customers you lose in a given period of time)

Conversion Rate:
Reveals a combination of the company’s ability to sell its products to its customers and customers’ desire for the product.
Good to track/review conversion rate over time & run experiments to improve it.

Monthly Burn Rate:
Understanding revenue and monthly expenses (fixed and variable) enables calculating the company's monthly burn. This is the net amount of cash flow for a month when net cash flow is negative (if a company's monthly net cash flow is positive, it is not burning cash)

Runway
A measure of the amount of time when the company runs out of cash, expressed in terms of months (computed by dividing remaining cash by monthly burn rate)

Net Promoter Score (NPS):
This is a measure of customer satisfaction. It's important to track your NPS to ensure your customers are happy with your product or service.