Subjective research case study On Profit-driven vs Growth driven Startups

What are the fundamental differences between a profit-driven and a growth-driven startup approach?

Growth can be measured and identified in many ways, but overall refers to the expansion of a company. Whether it be in operations, employees and size, market expansion, or new product development, business growth can present itself in different verticals.

Profitability, on the other hand, refers to the ability of a business to keep its gross earnings above or relative to the expenses associated with operations. In short, making sure the money you make can keep up with what you spend.

So how do these two concepts align, and where is the balance?

Many will come to a crossroads at a certain point in their business ventures where they feel they need to choose between growth and profit. And while both can be efficient and promising ways to scale a business, finding the route best for you is crucial in long-term business survival.

How is the financial landscape different for both of them, what are their metric of focus?

Profitability and growth go hand-in-hand when it comes to success in business. Profit is key to basic financial survival as a corporate entity, while growth is key to profit and long-term success. Investors should weigh each factor as it relates to a particular company.

How do startup priorities vary concerning financial strategies for these two models?

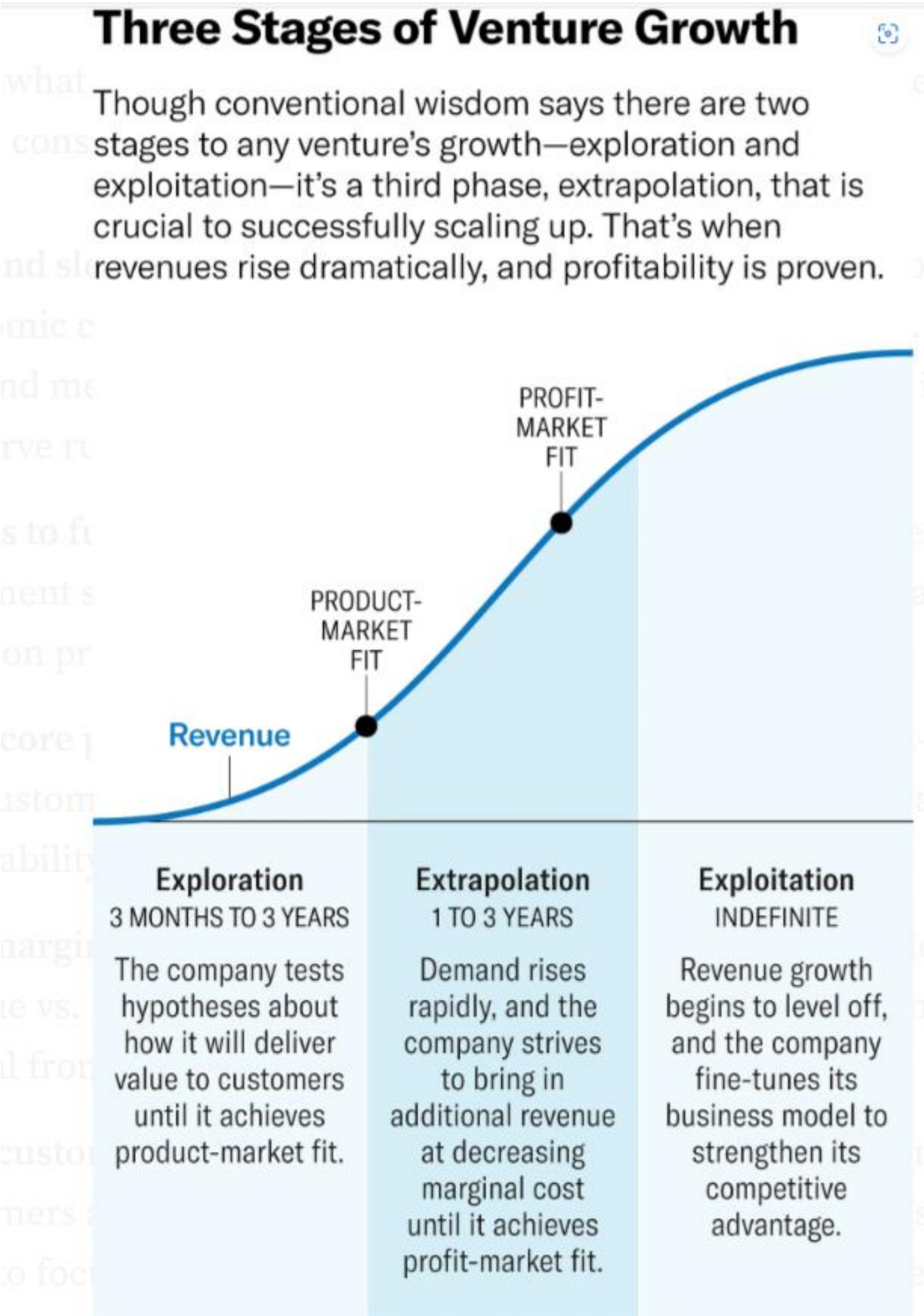
Key considerations for weighing growth versus profitability, such as:

- When to prioritize profit?
- When to prioritize growth?
- What are examples of companies that focused on profit vs. growth first?
- What growth and profitability metrics to track?

When to Prioritize Profit?

The conventional wisdom says growth should be the priority in a startup's early days. But emerging research suggests profitability should enter the picture sooner than most founders think.

Research shows that shifting to a profit focus earlier has benefits for startups down the road. An analysis of over 66,000 Finnish companies in the Journal of Business Venturing Insights found startups focused on profit earlier are more likely to perform better at both growth and profitability dimensions versus those chasing growth alone initially. It also found that profitability becomes increasingly more important as a company matures.



So under what circumstances does prioritizing profit make sense? Here are some key considerations:

- **Demand slows down —** customer demand may change due to factors like economic conditions, industry headwinds, interest rates, etc. Slowing demand means that there's less revenue growth potential, so it's time to conserve runway

- **Access to funding is uncertain —** When capital is scarce, investor sentiment shifts, or milestones for the next round look unattainable, focus on profitability can help extend runway
- **After core product validation —** after demonstrating product-market fit and customer traction, it's time to refine the business model and path to profitability
- **Low margin business model —** for startups competing on price and high volume vs. high margin, tracking and improving unit economics is crucial from the early stages
- **High customer acquisition costs —** when the costs of acquiring customers are too high relative to customer lifetime value, it signals a need to focus on improving unit economics before aggressive growth
- **Lifestyle business goal —** for founders not focused on building unicorns or billion-dollar exits, profitability may take priority

The key is assessing the internal and external constraints that may limit runway or growth potential, and determining whether a strategic pivot to profitability is appropriate given those circumstances.

When to prioritize growth?

While research shows focusing on profitability sooner has benefits, rapid growth should still be the top priority in a startup's earliest days. Here are some scenarios where focusing on rapid growth could be the wise strategic choice:

- **Fast-growing market —** when the overall market is experiencing rapid adoption and growth, capitalize on the rising tide by fueling growth
- **First mover advantage —** when it's a disruptive innovation or new business model, grow to capture market share before competitors, especially if it's a winner-take-all or winner-take-most market
- **Abundant capital —** when funding is readily available and investors are prioritizing rapid growth, utilizing capital to aggressively expand rather than focusing on near-term profitability can align interests
- **Before product-market fit —** when the product is still in development and product-market fit remains unproven, the focus should be on iterating, building, and finding traction
- **Network effect —** for businesses that benefit from network effects such as marketplaces and social media platforms, unfavorable unit economics early on are typical and can be offset by focusing aggressively on growth. Focusing on growth to achieve scale can justify delaying profitability until the market is established
- **Economies of scale —** for businesses like manufacturing and infrastructure with high fixed costs, growth is key even at a loss in order to reach economies of scale and drive down unit costs over time. The larger the scale, the higher the profitability

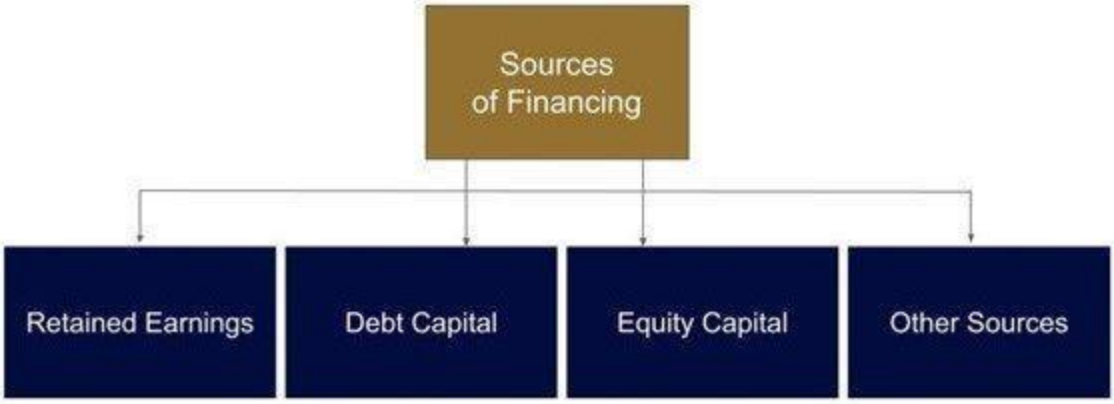
- **Adjacencies and new products —** when new complementary products or markets significantly expand TAM, aggressively expanding to them before competition arises can be prudent

While rapid growth at the expense of profits can be strategically timed to capitalize on opportunities, growth cannot be sustained forever without eventual profitability. The key is evaluating whether the timing to reach profitability should be immediate or longer-term depending on factors such as those listed above.

Identify common sources of funding for profit-driven versus growth-driven startups. How do they impact the company's trajectory?

The different sources of funding include:

- Retained earnings
- Debt capital
- Equity capital
- Other sources, such as crowdfunding



Key Highlights

- The main sources of finance are retained earnings, debt capital, and equity capital.
- Companies use retained earnings from business operations to expand or distribute dividends to their shareholders.
- Businesses raise funds by borrowing debt privately from a bank or by issuing debt securities to the public.
- Companies obtain equity funding by exchanging ownership rights for cash from investors.

Retained Earnings

Businesses aim to maximize profits by selling a product or rendering a service for a price higher than what it costs them to produce the goods. It is the most primitive source of funding for any company.

After generating profits, a company decides what to do with the earned capital and how to allocate it efficiently. The retained earnings can be distributed to shareholders as dividends, or the company can reduce the number of shares outstanding by initiating a stock repurchase campaign.

Alternatively, the company can invest the money into a new project, say, building a new factory, or partnering with other companies to create a joint venture.

Debt Capital

Companies obtain debt financing, or debt capital, privately through bank loans. They can also raise capital by issuing debt to the public.

In debt financing, the issuer (borrower) issues debt securities, such as corporate bonds or promissory notes. Debt issues also include debentures, leases, and mortgages.

Companies that initiate debt issues are borrowers because they exchange securities for cash needed to perform certain activities. The companies will be then repaying the debt (principal and interest) according to the specified debt repayment schedule and contracts underlying the issued debt securities.

The drawback of borrowing money through debt is that borrowers need to make interest payments, as well as principal repayments, on time. Failure to do so may lead the borrower to default or bankruptcy.

Equity Capital

Equity capital, or equity financing, refers to the funds a company raises by offering ownership stakes, either publicly or privately, in exchange for investment. Compared to debt capital funding, companies with equity capital don't need to make debt and interest payments. Instead, company profits are shared with investors.

Stock Market

Companies can raise funds from the public by offering ownership stakes in the form of stock. These ownership stakes are represented by shares issued to a wide range of institutional and individual investors. When investors purchase these shares of stock, they become shareholders.

However, one disadvantage of equity capital funding is sharing profits among all shareholders in the long term. More importantly, shareholders dilute a company's ownership control as long as it sells more shares.

Private Market

Private equity capital is secured from private investors, such as venture capitalists or private equity firms. Companies raise funds from private investors in exchange for significant ownership stakes, often with a hands-on role in the company's strategic direction. Private equity and venture capital are common sources of equity capital for companies that are not yet publicly traded or are in the early stages of development.

Other Funding Sources

Other funding sources include crowdfunding, donations or grants, and subsidies that may not have a direct requirement for return on investment (ROI).

What is Crowdfunding?

Crowdfunding represents a process of raising funds to fulfill a certain project or undertake a venture by obtaining small amounts of money from a large number of individuals. The crowdfunding process usually takes place online and is a common source of finance for startup businesses

Donations

Donations are a common way for nonprofits and social enterprises to raise the funding they need to carry out their mission without the pressure of generating profits. Donors who give money to nonprofits or social enterprises are motivated by the cause rather than financial returns.

Government Grants and Subsidies

Grants and subsidies are examples of financing provided by government agencies to support specific projects, initiatives, or sectors that align with public policy goals. Grants commonly provide funding for research, education, environmental protection, or community development.

Subsidies are financial assistance programs designed to lower the cost of goods or services, making them more accessible or promoting particular industries. Agriculture is an example of an industry that frequently receives government subsidies.

Any business aiming to grow, innovate, or simply maintain stability in a competitive market should understand the various sources of funding. Whether it’s retained earnings, debt capital, or equity capital, each funding option comes with its own set of advantages and challenges. Businesses need to carefully evaluate their financial situation, growth plans, and overall strategic goals to choose the right mix of financing options. Additionally, exploring alternative funding sources like crowdfunding, donations, or government grants can provide valuable support without the obligations of traditional financing.

Ultimately, the key to successful financing lies in balancing immediate needs with long-term objectives, ensuring that the chosen funding sources align with the company’s vision and capacity for growth.

What metrics or key performance indicators (KPIs) distinguish success for profit-driven and growth-driven startups?

Key Performance Indicators also commonly known as KPI's are those measurable values that show how effectively a company is achieving its objectives. To fully assess the business performance, the key performance indicators are used at several levels.

The low level indicators focus on specific departments like marketing, sales, purchase, HR. The high level indicators focus on the overall performance of the business. Based on this, it is also decided which business processes need the key performance indicators.

In the case of start-ups, there are 8 important start-up KPIs. These KPI's are as mentioned below:

- Customer Acquisition Cost
- Average Sales Cycle Length
- Active Users
- Cash Runaway
- Customer Churn Rate
- First Response Time
- Gross Profit Margin
- Revenue Growth Rate

Profit-Driven Startups:

- Profit Margin: This KPI assesses how efficiently a startup generates profit from its revenue. It’s calculated as follows:

Profit Margin=Total RevenueNet Profit×100%

- Gross Margin: Similar to profit margin, but it focuses on the profitability of individual products or services.
- Customer Lifetime Value (CLTV): Measures the total value a customer brings to the business over their entire relationship with the company.
- Customer Acquisition Cost (CAC): The cost of acquiring a new customer. Lower CAC is desirable.
- Churn Rate: The percentage of customers who stop using the product or service. Lower churn is better.

Growth-Driven Startups:

- Monthly Recurring Revenue (MRR): The predictable revenue generated from subscriptions or recurring services.
- User Acquisition Rate: How quickly the startup acquires new users.
- Retention Rate: Measures how well the startup retains existing customers.
- Virality Coefficient: Indicates how many new users each existing user brings in.
- Product-Market Fit Score: Assesses how well the product meets market demand.

In what ways do profit-driven and growth-driven models impact long-term sustainability and stability?

Profit Driven:

In recent years, a significant shift has been observed in the startup ecosystem: a move from prioritising revenue growth to focussing on profitability.

This trend is particularly noticeable in the Indian startup landscape, where the mantra of "growth at all costs" is being replaced by sustainable and profitable business models. This article explores the reasons behind this shift, supported by real data and insights into the latest trends.

This approach was fuelled by the belief that capturing market share quickly would lead to long-term dominance and profitability.

Consequently, startups often focus on top-line revenue growth, sometimes at the expense of hefty losses. Investors, too, were more willing to pump money into high-growth companies, betting on future profitability once a dominant market position was secured.

Startups are employing several strategies to pivot towards profitability:

Cost Optimisation: Reducing unnecessary expenses and optimising operations is crucial. For instance, startups are renegotiating vendor contracts, automating processes, and adopting lean methodologies.

Revenue Diversification: Relying on multiple revenue streams helps mitigate risks. For example, fintech startups in India are expanding their services to include wealth management, insurance, and lending.

Focus on Core Competencies: Startups are narrowing their focus to core products and services that offer the highest margins. This approach helps in better resource allocation and enhances customer satisfaction.

Data-Driven Decision Making: Leveraging data analytics to understand customer behaviour and market trends allows startups to make informed decisions, improving profitability.

Strategic Partnerships: Forming alliances with other companies can help in sharing costs and accessing new markets. For example, ecommerce startups partnering with logistics firms to reduce delivery costs.

Growth Driven:

A good sustainable growth rate (SGR) for a startup in the United States is generally considered to be a rate that allows the company to grow steadily over the long term. A good SGR means they do this while maintaining profitability and avoiding excessive debt. While there is no one-size-fits-all answer to what a good SGR is for a startup, a rate of 10-20% per year is generally considered to be sustainable for most companies. However, the sustainable growth rate can vary depending on factors such as the industry, market conditions, and the stage of the startup.

One of the most effective startup growth hacks is growth marketing. Growth marketing is a data-driven, iterative approach to marketing that focuses on rapid experimentation and testing. This is done to identify the most effective channels and tactics for driving growth. Growth marketing involves a range of tactics, including search engine optimization (SEO), social media marketing, email marketing, and content marketing. It is particularly effective for startups that have limited resources and need to maximize their ROI on marketing investments.

Another effective strategy for achieving sustainable growth is to focus on customer acquisition and retention. Startups can achieve sustainable growth by acquiring new customers and retaining existing ones. They can do this through targeted marketing campaigns, exceptional customer service, and product improvements. Startups can also leverage referral marketing to incentivize existing customers to refer their friends and family.

Product development is another critical aspect to consider. Startups need to continually improve their product or service to meet the changing needs and demands of their target market. By gathering feedback from customers and analyzing market trends, startups can identify opportunities to improve their products or services. This will ensure they differentiate themselves from competitors.

Finally, startups can achieve sustainable growth by partnering with growth marketing agencies. These agencies specialize in helping businesses accelerate their growth rates through data-driven marketing strategies and tactics. Growth marketing agencies can provide startups with the expertise and resources they need to execute effective marketing campaigns and achieve sustainable growth.

What are the primary challenges faced by profit-driven startups, and how do they differ from those faced by growth-driven startups?

Fierce Competition:

There is always competition between the giants in the corporate world. Competition can be a major barrier to startup businesses' survival. And the competition gets even tougher when you have an online business startup.

Because there is no margin for error, the competitive environment keeps companies on their toes. Both B2B and B2C businesses are always feeling the heat of strong competition. To survive in this competitive business environment, which includes both traditional and internet enterprises, entrepreneurs must play aggressively and punch above their weight in order to obtain much-needed exposure amongst the clusters of constantly challenged and increasing businesses.

Knowledge and skills gap:

It's unlikely that you'll know everything there is to know about running a business as a first-time entrepreneur. A lack of understanding can lead to costly blunders that could have been avoided. You'll also have to deal with a lot of demands on your time and energy when starting a business.

Finance management:

Poor financial planning is one of the leading causes of startup failure. Your business will fail if your costs exceed your revenue.

Failure to plan:

The excitement of a new business idea can make it tempting to launch without much forethought. However, a lack of planning can result in your business running out of cash or being unprepared for critical activities such as marketing or dealing with suppliers. Business owners who plan ahead of time and set goals for themselves are more likely to succeed.

Unrealistic exceptions:

Success does not happen by itself. It brings with it expectations. Most of the time, these expectations appear realistic, but in reality, they are merely unrealistic. The same holds true for new businesses.

An ineffective marketing campaign:

There is a risk of getting caught up in the current marketing fads that can result in you spending more on marketing strategies than the sales they produce.

Making the right hires:

The workers you hire can make or break your startup's success. A bad employee can have a significant impact on team morale and productivity. It's difficult to fire someone, but having the wrong people in your startup can cause a lot of problems.

Outline scenarios where a profit-driven strategy might outperform a growth-driven one, and vice versa.

To be successful and remain in business, both profitability and growth are important and necessary for a company to survive and remain attractive to investors and analysts. Profitability is, of course, critical to a company's existence, but growth is crucial to long-term survival.

- When evaluating a company, what should you weigh heavier: profitability or growth?
- A growing company may not be earning any profits yet, but may nevertheless provide a great investment opportunity.
- Other times, a lack of profitability can be a huge red flag that something is wrong with the firm.

As an example, a 40% growth company may be operating at a break even, and a 10% growth company may be operating at a 20% profit margin. If you are committed to driving both, you really only have one option: a medium growth scenario that drives medium profits. Continuing the example above, this could be a 25% growth company driving a 10% profit margin (the midpoints of the above examples). But, to make it clear: using the above examples, it is mathematically impossible to get a 40% growth rate and a 20% profit margin at the same time.

How does control and decision-making vary between these two models? What are the implications for founders?

The decision-making process and organizational strategy are closely knit together, as every business-critical decision plays a crucial role in shaping the strategic direction of an organization and strategy execution. Simultaneously, the organizational strategy provides the framework and context for decision-making, ensuring alignment, adaptability, and ongoing improvement in achieving strategic objectives. Decision-making and strategy are connected in the following ways.

- **Strategic alignment**

The decision-making process ensures that every decision is aligned with the organizational strategy, as the process is shaped by the organization's strategic goals, overall organizational objectives, and priorities. The organization's strategic direction directly influences strategic decisions, such as venturing into new markets, developing new products, making investment decisions, etc.

- **Resource allocation**

Resource allocation or resource management is one of the key aspects of strategy that requires making highly informed choices. Listing the various projects, initiatives, business units, tasks, and operations and judiciously allocating adequate financial, human, and technological resources for each play an essential role in supporting the organizational strategy. These decisions are made based on strategic priorities and the desired outcomes.

- **Risk management**

Calculated risks are part of strategic decision-making while pursuing opportunities and addressing challenges. So achieving strategic objectives requires risk management. A structured decision-making process helps you identify potential risks, forecast their potential impact on the organizational strategy, find alternatives and workarounds, and determine the risk mitigation strategies. It also gives you a complete understanding of the risks and opportunities while making decisions.

- **Strategy execution**

Strategy execution necessitates effective operational, tactical, and strategic decision-making. A structured, systematic decision-making process ensures uniformity, coherence, and continuity in decision-making so that the strategy gets translated into sound, actionable decisions with clear goals, action plans, and performance metrics. All these decisions at various levels of the organization come together and collectively contribute to the strategy execution.

- **Adaptive decision-making**

As the organizational strategy is constantly adjusted and adapted to changing conditions and emerging developments in the business environment, the decision-making process plays a key role in enabling organizations to adapt to new circumstances, market trends, customer preferences, and competitive forces. Making strategic decisions in line with the organization's changing needs helps you effectively respond to internal and external challenges.

- **Learning and continuous improvement**

Since the decision-making process involves evaluating the outcomes and impact of the decisions, collecting feedback, and analysing the effectiveness of the process, it provides you with the opportunity to learn continuously and identify areas of improvement in the strategy and strategy execution.

Implications to founder:

The biggest job a founder must do is make decisions. In any organisation, at any level, there are always decisions to be made: small decisions like which task to work on first and which social media creative to post at noon; and bigger tasks like which product gets a bigger chunk of the marketing budget to which new product gets rolled out first.

Founders need to gather and exchange information, evaluate and review data, and implement directives. And the higher up you go, the more pressure there is to make quick decisions that can give direction to the teams and people who aid the execution process.

Critical Decision-Making Skills

Founders face a conundrum: unlike traditional CEOs in established organisations who are rarely tasked with making small day to day decisions, founders grapple with small decisions and far more complex ones.

As a startup founder, you need to look predominantly at growth, and work with your marketing and sales teams to deliver. You need to evaluate risks and opportunities, identify factors that can affect the outcome of a decision, anticipate outcomes, establish priorities, factor in a degree of uncertainty and use sound reasoning based on inputs from your managers and team leads.

It's a lot to take in – but with the right data and inputs, decision-making (even in urgent scenarios), will feel less daunting.

Looking Down, Managing Up

As a founder, you rely on inputs from your other team members like your sales heads, marketing heads, growth heads and product heads. And it's a chain – those very people have come up with those inputs after a fair amount of decision-making on their part (related to the day-to-day processes within their scope).

Since decisions at every level can impact the organisation, you need to be sure that the inputs you get – and the decisions you make – are in line with the overall goals of the company.

The term "manage up" is used by many people in the mid-management level as a method to influence founders to take a decision that will support their particular team's projects and goals. Now, this can be tricky territory, since some people may place their own personal gain over collective organisational gain.

As a founder, you need to listen to all sides and take your manager's and team lead's inputs into account – but you also need to have your pulse on what's best for the organisation in the long-run. You have to see if the decision you take (which is put forth as favourable by the manager/team lead) is aligned with the organisation's overall goals and drives growth and success for the company.

Your team may feel the need to manage up – but you need to look downstream and understand the organisational waters better so you can help your team navigate a successful path upstream where the collective goal is achieved, not just the individual. You have to look down, to handle things when colleagues aim to manage up.

Manage what You Measure

Founders are responsible for management, execution as well as managing execution. And as you oversee and manage the execution of projects and processes, you must take decisions that will lead to better business outcomes.

So it's safe to say you can only make a decision when you know what the possible outcomes are – and you can only understand the outcomes ahead when you know what to ask your managers and team leaders. You may not be executing each campaign and strategy – but you must know what to look for.

A founder need to:

- Understand the metrics.
- Understand team KRAs and processes.
- Understand the KPIs that will help you gauge those metrics.
- At the end of the day, you can only manage what you measure – otherwise, it's decision making rooted in ambiguity. Exceptional decision makers in high leadership positions create clarity out of ambiguity, and find timely solutions that set your business on the right path. And this can only happen when you ask the right questions, at the right time, to the right people, about the right things.

Considering the industry landscape, when might a profit-driven approach be more suitable, and when would a growth-driven model be more appropriate?

When to Prioritize Profit?

The conventional wisdom says growth should be the priority in a startup's early days. But emerging research suggests profitability should enter the picture sooner than most founders think.

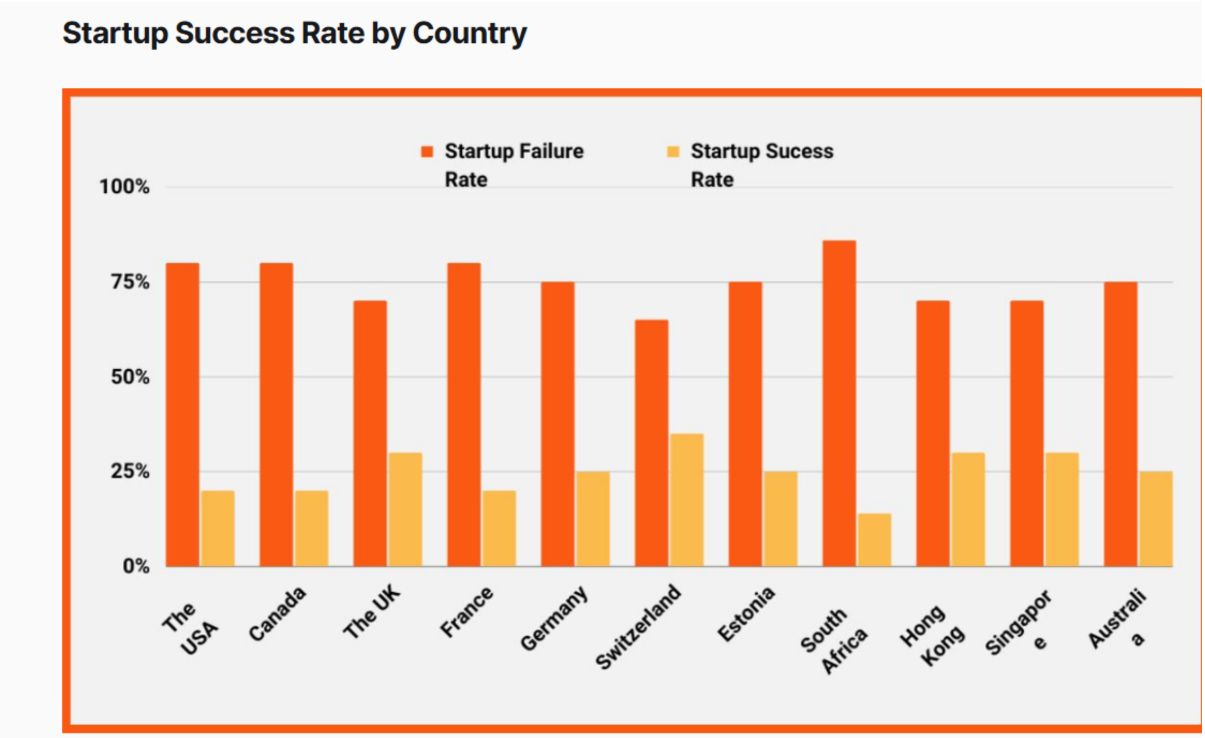
Research shows that shifting to a profit focus earlier has benefits for startups down the road. An analysis of over 66,000 Finnish companies in the Journal of Business Venturing Insights found startups focused on profit earlier are more likely to perform better at both growth and profitability dimensions versus those chasing growth alone initially. It also found that profitability becomes increasingly more important as a company matures.

Identify key lessons or takeaways from real-world examples that showcase the success or failure of either approach.

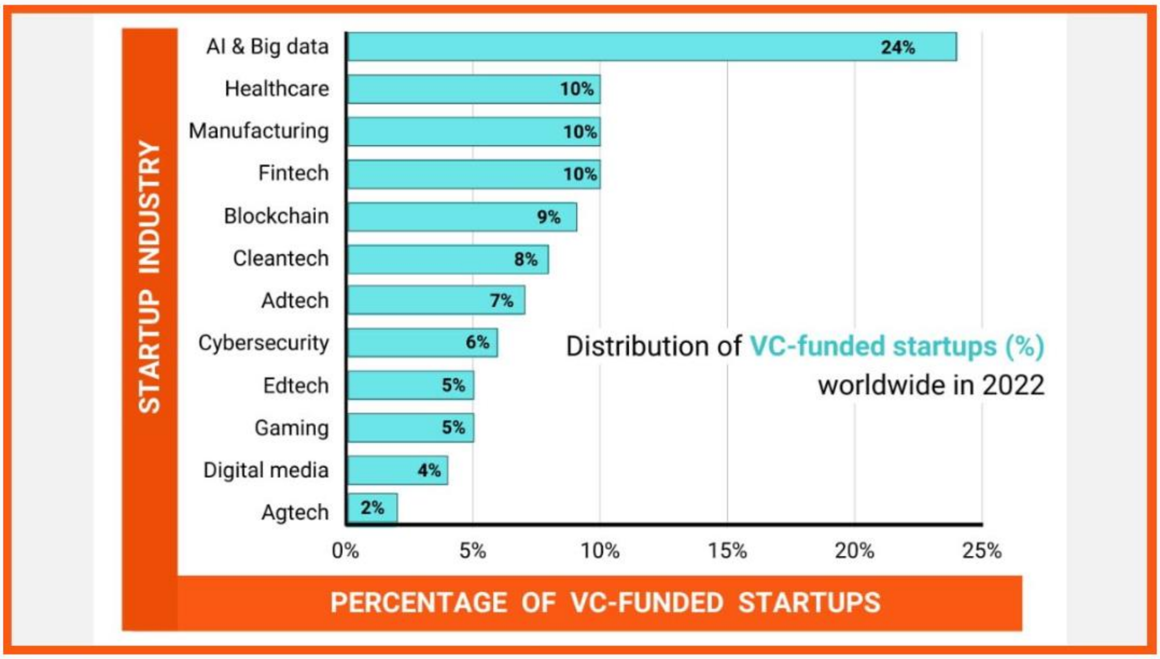
Key Insights From the Report:

- Almost 90% of startups fail.
- The information industry has the highest failure rate at 63%.
- 27% of male-led startups successfully exit the VC as compared to 17% of women-led startups.
- Female-owned startups receive only 2.3% of VC funding.
- Cryptocurrency and digital healthcare startups have the highest failure rates at 95% and 98%, respectively.
- 33% of startups survive 10 years of operation.
- A startup founder with a successful venture in the past has a 30% chance of success.

- The USA is home to the most number of startups, at 74,623, and more than 50% of all unicorns are located there.
- 80% of startups in India fail within 5 years.
- $3000 is the average cost of starting a small business.
- 75% of startups backed by VC funding fail.
- Fintech is the dominating industry, as 7.1% of all global startups fall in this category, with a market size of $310 billion.
- The Y Combinator failure rate is 20%, but it is subjected to various factors.



Startup Failure Rate and Startup Success Rate by Country



Percentage of VC-Funded Startups Worldwide

Resources:

- https://medium.com/@phoebez/profitability-vs-growth-a-dilemma-for-startups-26ebff14f665
- https://www.forbes.com/councils/forbesfinancecouncil/2024/03/21/navigating-the-balance-growth-vs-profitability-in-business/
- https://corporatefinanceinstitute.com/resources/accounting/sources-of-funding/
- https://www.jigsawmetric.com/blog/kpis-for-early-stage-startups
- Startup Failure and Success Rates: 2023 Research (startuptalky.com)
- More Important for a Business, Profitability or Growth? (investopedia.com)