# Checklist of Business Indicators which Drive Startup Valuation

For DougL's Ruminant readers, here is handy checklist of key business indicators (in order of general importance; your mileage may vary) which contribute to valuation:

☑ **The Founder(s) and later, the CEO and Executive Leadership Team (ELT)**

☑ **Growth**

- Revenue growth rates heavily influence startup valuations. The following are a range of expected growth rates a startup in the first three years:
  - 1st year startup revenue growth rates will range from 150% to 200%
  - 2nd year startup revenue growth rates will range from 100% to 150%
  - 3rd year startup revenue growth rates will range from 50% to 100%

☑ **Revenue Visibility & Predictability**

- Positive Indicators: Business, revenue, pricing/licensing models
  - SaaS subscription models especially
- Negative Indicators:
  - Traditional software model based on license revenues
  - The professional or consulting services model
  - Many B2B business models – especially with enterprise customers – producing very lumpy sales, interspersed revenues with small sales
  - Episodic, difficult-to-predict revenues
  - Business and industries based on "big hits" – such as media companies, entertainment and gaming
  - Businesses with high DSOs

☑ **Gross Margins**

- Defined as Sales minus All Expenses divided by Revenues – and influenced by industry, segment, type of product (SaaS, software, cloud vs. hardware), services component, cost of goods sold (COGs), etc.)
- Many first-time founders and CEOs define COGs too expansively. Watch this!
- Average gross margins for a SaaS startup will range from 80-90%
- For post-IPOs/public companies: 70-90%

☑ **Profitability & Scaling**

- Net Profit is defined as the Revenue that's generated after deducting All Expenses
- Mileage will vary based on many factors
- As a company scales it produces higher revenues and higher profit margins
- Obviously, increase profitability while growing results in higher valuations

☑ **Sustainable Competitive Advantage**

- Building products or offering services that are more innovative, built better, deliver ROI faster, or are less expensive than alternatives in the market.

    - More details in Michael Porter’s book entitled **Competitive Advantage**.
    - This factor is paired with **Disruptive Innovation**

☑ **Disruptive Innovation Potential**
    - Defined as invention, product and/or technology advances that have the potential to create a new market.
    - Creation new value networks
    - Displace established companies, products, services, and their supply chain and partnerships.
    - More details in Clayton Christiansen’s book entitled **Disruptive Innovation**
    - This factor is paired with **Competitive Advantage**

☑ **Network Effects**
- Defined as the value of adding of one incremental customer stemming from the company’s and product’s online community, self-service infrastructure, design approach, marketing and branding, customer base and network effects dynamic
- For users, the value of network effects is directly related to the size and variety of the community of users but also related to the software interface that facilitates accessibility.

☑ **Customer Retention**
- Low churn and high switching costs are key to customer lock-in
- In other words, valuation using this indicator reflects a company's ability to turn customers into repeat buyers and prevent them from switching to a competitor

☑ **Customer Concentration & Dependencies**
- Customer Concentration is defined as the quantity of total revenue that is distributed among your customers
- This is challenging for early-stage companies because the number of customers are fewer than later-stage companies
- The percentage of customers by size, segments, geographic location and actual purchases
- The critical mass of customers (for B2B pre-Series A: 20-25
- Develop offsets for concentrations

☑ **Partners & Dependencies**
- Like customer concentration
- The number of partners, percentage in distribution type, size and market power
- Partnerships require time to develop

☑ **Organic Demand vs. Merely Marketing**
- Investors rebel against a heavy reliance on marketing activities & expenditures
- Key metric: The cost of acquisition of customers (CAC).
- Investors are attracted to companies with demonstrable organic demand with strong network effects