PLANES, TRAINS & AUTOMOBILES: Deconstructing A Startup's "Road to Revenue"

As business development strategists, we're amazed at how often we encounter early-stage venture startups that either can't articulate a simple 12-month revenue goal or, even worse, have arbitrarily set unrealistic sales targets with no clear "Road to Revenue." What's even more extraordinary is that many of these ventures have successfully secured funding, and have an active board of advisors. They may have an early generation product, a tested value proposition, and a few revenue-generating anchor clients. And from there, we've witnessed startups roll out an exorbitant, one-year, multi-million dollar revenue projection without any sense of feasibility - context, timeframe, resources, or sales plan.

It's a bit like setting someone down in Vancouver, Canada... someone with no knowledge of the country's size, terrain, climate, or season... and telling her she'll be expected to reach Halifax in one hour. (Can't be done - at least not until Elon Musk builds a low-stratosphere rocket-liner.) It takes a minimum 10 hours to cross Canada by plane. And that assumes timely connections at all layovers, with no icing delays. Allow for two days, and you can look at options that include a plane to Quebec, and a train or car rental for the remainder. Allow for 5-6 days, and you could tackle the country exclusively by train or automobile. But it's humanly impossible to cross the Great White North in under 10 hours regardless of technology. No amount of will power or sweat equity can change that fact.

And yet that's exactly the demoralizing mistake we've seen ventures make in their early years when laying out arbitrarily inflated revenue goals with no sense of reality. They simply set themselves up for failure. And why? Because they don't deconstruct their sales goals in a way that properly identifies a logical, plausible, and time-sensitive "Road to Revenue." It inevitably leads to mismanaged expectations, disgruntled investors, and a stalled sales program; all while continuing to indulge a bullish "burn-rate" that wreaks havoc on the company's cash position, triggering disruptive staff turnover and lay-offs.

HOW TO ENGINEER A PLAUSIBLE ROAD TO REVENUE

So how do you engineer a proper, more plausible "Road to Revenue?" Start with the following:

FINANCIAL FUNDAMENTALS

- *Break-Even Evaluation* - Start with understanding baseline survival. How much recurring revenue achieves break-even? That is your minimum benchmark to keep the doors open without necessarily requiring more funding. Be mindful that a sales and marketing operation is still required to simply sustain break-even. Has that been factored into your burn rate? All this taken together represents your minimum recurring revenue target. Depending on your situation, this could easily take 1-3 years to achieve.
- *Growth Rates & Cash-Flow-Positive Calculations* – Bear in mind, however, that a "Break-Even" calculation does **NOT** take into account your growth rate. It simply establishes the minimum volume of business required to sustain a minimum operating level. You're just treading water. In actuality, you need to fuel growth. And growth requires additional funding – either internally generated or externally financed. So a "cash-flow-positive" operation that accounts for both a minimum operating level and even a modest rate of growth typically requires a higher annual recurring revenue target than simply baseline break-even. Moreover a cash-flow-positive calculation can *vary* depending on the target rate of growth. So you need to think about what kind of growth engine you can realistically afford to put behind your venture in your first few years of commercialization. And while you might be able to achieve a break-even position (in theory) after one year, you may not be in a self-sustaining, cash-flow-positive position for 2-3 years (as an example) depending on your target rate of growth.

"Break-Even" and "Cash-Flow Positive" Operations Are *Not* Necessarily the Same Thing:

- Break-Even Operations Are Just Keeping The Doors Open. It's a Fixed Figure.
- Cash-Flow-Positive Operations Account for Varying Self-Sustaining Rates of Growth.

So why even calculate "Break-Even" if "Cash-Flow-Positive" is the early-days end game? Because growth rates are very difficult to predict, whereas your "Break-Even" calculation is based almost entirely on internal factors you know and can control. So start with what you know for certain, and then begin to extrapolate. Moreover, if you ever go through a period of retraction, where cash is limited, and you need additional financing, then you will want to know what your baseline revenue operations must be to keep from "shuttering" your doors. If you're at or above break-even, then you're in a stronger, safer position to negotiate with additional funders.

But then, having said all this so far, how do you begin to target for and predict a plausible growth rate? That's where some of these additional considerations come into play. Questions you should be asking:

PRODUCT READINESS

To what degree is your product fully proven, and value proposition tested, across what you believe to be your initial target markets? How many times have you actually sold your product (or service) at what you believe to be fair market rate? Are you only just transitioning from pilot programs to paying customers, or have you secured multiple revenue-generating anchor clients, and are now ready to replicate and scale? Assuming you have deployed your product repeatedly, are you confident it's functioning properly, or are you still calling upon product development to revise and refurbish? If the latter, are you only making minor tweaks, or are there still noticeable "gaps" in your overall offering relative to what either the customer expects, or your competition can already deliver? If your product is sound, you have a reasonable book of paying business, and you've verified your best potential markets, then you may be in a position to pursue a more bullish growth rate. If you're still piloting (even in part), and your product is not entirely "market-ready," then you're ultimately not prepared to scale your growth.

MARKET REALITIES & THE COMPETITION

What's the present state of the market? Are you a first-mover, a close second with a distinct value proposition, or are you facing significant competition with limited ability to differentiate. If you're a first mover, then is the buying audience ready to adopt what you have to offer? Are you addressing a clearly ubiquitous pain-point for a wide set of targets, or do you need to create your market through persuasive "edu-selling" campaigns? Would your market buy on the spot, or are you facing a longer sales cycle to overcome a prospect's fear of adoption, resistance to change, or budgetary procedures?

If you're a second mover, then is your value proposition clearly distinct, and are your marketing efforts loud enough to advertise the difference. If you're late to the game, how congested is the overall market? How long will it take for you to make noise with your own voice? Moreover, what's the size of the market? Is there enough business to go around, or is there a risk of over-saturation. Assuming you can still chase a sizeable piece of the pie, how easy is it to identify, profile, and contact your targets?

Pegging Revenue Targets to Competitor Performance – One way to estimate your early-stage growth trajectory is to run an historic analysis on your competition. While not always the case, you may sometimes have access to published information regarding a competitor's financial performance. If so, then do some simple math to approximate their past growth trajectory, most especially if they're considered one of the industry leaders. If your competition reported $5 million in annual revenues after 5 years, then a straight-line estimate would suggest they grew their business $1 million in revenue per year. And yet most growth scenarios see more of an escalating curve, followed by a smoothing out over time. Which means that the first year more than likely saw the competition land less than $1 million in revenue. As such, you might assume revenues of between $250,000-$750,000 in your first year (as a hypothetical), but aim to surpass $1 million. If you do secure $1 million + in revenues in Year 1, then you may well be achieving a competitive edge over the incumbents. Of course, all this depends on when your competition entered the market. If you're working off recent financial performance, then you can fairly safely

assume an "apples-to-apples" comparison. If they launched 15 years ago, then a change in market realities may not allow you to draw as close a parallel. All assumptions need to be balanced with context and common sense.

One Way to Estimate Your Early-Stage Growth Trajectory Is To Run An Analysis On Your Competition. Peg Your Growth Objectives Against Their Historic Performance.

MARKET-ENTRY STRATEGY

Your market-entry strategy is also going to have a significant bearing on your potential rate of growth and target revenues. Outlining the many different go-to-market scenarios available for both low-tech and high-tech venture startups is beyond the scope of this paper. But let's consider even the basic differences between the following:

- Direct-to-Market
- Strategic or "Channel" Partnerships
- Shared Marketplace (e.g. "App Stores" within an established eco-system such as a WordPress user base.)

Simply put, any form of "Direct-to-Market" strategy may well require a longer horizon for you to establish a recognizable voice, reputable brand, and subsequent sales momentum. Partnerships and "Shared Marketplaces," on the other hand, may allow you to boost your revenue projections early on, given that you may accelerate access to an easily identifiable, active, and possibly captive audience of probable buyers. On the flipside, you'll be giving up margin to leverage said partnerships. So your total number of sales or "closed deals" through Channels and "Shared Marketplaces" will need to be higher.

Other strategic considerations? Is your market offering a formulaic "retail" play that's easily communicated, with a straightforward, unitized pricing model? Or are you chasing more complex, enterprise dialogues that have much longer sales cycles, and require client-specific concessions in pricing and deliverables? Is your price-point low? Does it fall within a discretionary spending level? Or is it a bigger ticket item that may require a pre-planned budget? Are you targeting only one decision-maker in a typical conversation, or will you need to convince multiple stakeholders to adopt your solution before you can close a deal? Is your product or solution easy to learn, or does the on-boarding process require an extended timeframe? How disruptive would your solution be to the customer's daily operations? Could there be a period of adjustment or preparation required before the customer can embrace your solution, and make a decision to buy?

All of these variables have a significant bearing on the complexity of the sale, and the probable length of your sales cycle. In turn, you should ensure your initial revenue projections reflect these market-entry realities.

PIPELINE METRICS & SALES CAPACITY

How many sales, and ultimately how many leads, do you need in order to reach your projected revenue target? And what human effort is required to reach those numbers? This is perhaps one of the most important calculations you should estimate before committing your company to a specific revenue goal. Breaking down your deal-by-deal effort is an extremely illuminating exercise. It will reveal to you the resources required to get the job done. Inevitably, most startups discover that they've sorely underestimated what's needed, and that their sales capacity is not adequate for the task.

Building your Pipeline – It's a Matter of Math provides a detailed examination of what it takes to evaluate the total sales effort behind a revenue target.[1] In short, though, you need to estimate your average deal valuation, followed by the resulting number of deals required by year-end to achieve your goal. Working backwards, you'll then need to anticipate conversion rates throughout every stage of your sales process, as well as the hours of effort to push a prospect through to the next stage of your pipeline. Qualifying a suspect lead, delivering a demo, triggering a discovery dialogue, drafting a formal proposal, and finally closing a contract – all these tasks require either human

[1] https://www.canadastartup.com/wp-content/uploads/2017/07/Building-Your-Pipeline-Its-A-Matter-of-Math.pdf

agents, or some form of sales and marketing automation. Either way, these resources take time and money to properly position. Every sales cycle, of course, is slightly different depending on the product and target market. But in some fashion, there is a process from door-knocking to deal-close that needs to be structured and benchmarked. Once you put metrics to the different stages of your pipeline (estimated conversation ratios and hours of effort), you will begin to understand where you may have shortfalls in your sales capacity. Some of the following issues will arise:

- Are you generating enough qualified leads to feed your pipeline? Are these only "marketing qualified" inbound leads, or "sales qualified" leads generated through direct outbound effort? Do you need to spend more money on either of these efforts? If you can't afford to do so at this time, do you need to adjust your revenue projections and/or seek additional funding?
- The average sales agent might have between 1,450 and 1,500 hours available each year to sell your solution. This is after taking weekends, vacations, internal demands (meetings, administration, research and development), and other distractions into account. Consider the hours of effort required to maintain a funnel large enough to achieve your present revenue objectives. Do you have an adequate volume of marketing staff and sales agents to generate leads, qualify opportunities, conduct demonstrations, escalate dialogues, and draw up proposals? If no, can any of these steps be automated to reduce human inputs? Can you ultimately steer your company towards a "self-serve" retail model, or will you always require a degree of "hands-on" sales effort. Same with on-boarding your clients – can you rely on video tutorials and posted content, or will there need to be a certain amount of human-centric training required to actively deploy your solution at a client location?

These are just some of the questions that will arise, and that will help you to understand whether you have a sales engine big enough to accomplish your revenue objectives. If the answer is "no," then you have two choices: increase your capacity to execute, or decrease your sales targets and revenue objectives.

SCENARIO A: You Need 200 Closed Deals To Reach Your Revenue Goal, And Each Deal Is Expected to Take 10 Hours to Execute (Start-to-Finish). You Only Have 1 Sales Agent Working 1,500 Hrs / Year. You Need to Adjust Your Capacity or Your Revenue Target.

SCENARIO B: 120 Closed Deals Achieves Your Revenue Goal, Or 10 Deals per Month. You Estimate That You Need 1,000 "Suspect Leads" (or 100 "Qualified Leads") Per Month to Reach Your Target. But You're Only Generating 400 "Suspect Leads." Time to Adjust.

This math may seem very simple, and remarkably intuitive. It is. But we're amazed at how many companies we encounter (both startup ventures and more mature operations) that fail to do the math, and then wonder why they aren't reaching their revenue objectives.

BUDGET REQUIREMENTS

There's a reason why a rocket is regularly used as the "lift-off" analogy for many venture startups. Roughly 85% of the NASA Shuttle's fuel mass on any given mission was used exclusively for initial launch. Venture specialists and their investors need to look at early-stage Sales and Marketing budgets (and corresponding operations) in very much the same way. It is not unheard of for a venture, once ready for mainstream commercialization, to allocate as much as 40%-50% of its total operating budget exclusively to sales and marketing; sometimes more. This assumes the company's goal is to achieve rapid, scalable growth.

As just one supporting example, some *SaaS* specialists will argue that a company should be setting aside a Sales and Marketing budget equivalent to 40% of their net-new revenue delta every year. Of course, when dealing with a startup in its first few years of active sales, that effectively means at least 40% of its total "break-even" operating

budget; and possibly more, depending on the mix of variables outlined above.
(http://saascribe.com/how-to-calculate-saas-marketing-budget/)

Sales & Marketing Budgets Can Easily Represent 40-50% of a Startup's Total Operating Budget in the First Few Years of Growth and Development.

GROWTH RATES & REALITIES

Circling back to growth rates, these are very difficult to forecast. But the variables behind them are certainly easier to identify. As a recap, here is a brief list of questions you should be asking yourself before you set a target:

- Are you a "first mover" in the market, or latecomer? What will it take to get noticed, and for how long?
- Is your product ready for scalable commercialization, or are you still piloting aspects of your offering?
- How well established is the competition? How long have they been at it? What was their growth rate?
- How big is the market? And how easy is it to find your target customers? Do you know the ideal profile?
- How many stakeholders do you need to meet before closing a sale? How does this affect your sales cycle?
- Does your price point represent a discretionary spend? Or would it require a budgeted line item?
- How difficult is your solution to adopt? Is it intuitive? Or disruptive and habit-changing?
- What are the metrics behind your sales process and pipeline? How many leads do you need? What's your conversation rate from leads-to-dialogues-to-deals? Are you achieving these metrics, or falling short?
- What's the size of your sales team? Do they have the capacity (in hours) to achieve their goals?
- What is the on-boarding process post-sale? Do you have the apparatus in place to get the job done?
- Can you automate aspects of lead acquisition, lead qualification, demos, and/or on-boarding in order to reduce costs, reduce head count, or shorten/simplify the sales cycle?
- If you don't have adequate sales capacity, can you fund additional marketing and sales effort? If "yes," are these added costs reflected in the "Break-Even" and "Cash-Flow-Positive" benchmarked targets?

Getting answers to these questions will certainly help you to establish more realistic revenue objectives.

INVESTOR EXPECTATIONS

Managing investor relations ultimately warrants a separate discussion of its own. But, simply put, you want to ensure there is always an ongoing alignment between the expected timing of your company's revenue milestones, your investors' own financial objectives, and the potential schedule of key liquidity events at which time investors can either "cash out," receive dividends, or "re-up" their stake in your company. If your investors are anticipating a two-year horizon to re-evaluate their involvement, and your growth projections don't anticipate a measurable milestone revenue event until the third year of operation, then you face a misalignment of expectations, and subsequent challenges appeasing your investors. Make sure you've constructed a logical, plausible, time-sensitive "Road to Revenue" that enables you to better educate your investors on milestones, risks, and opportunities up front. In turn, you can more effectively track progress, and manage expectations, along the way.

Your "Road to Revenue" requires a rigorous evaluation of multiple "Go-To-Market" variables, and should be laid out in a logical, plausible, and defensible fashion. Arbitrarily setting sales goals without weighing market realities, gauging competition, and measuring your own capacity, will set you up for failure. You'll frustrate your investors and demoralize your team when you don't achieve your targets.

Need further insight?

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