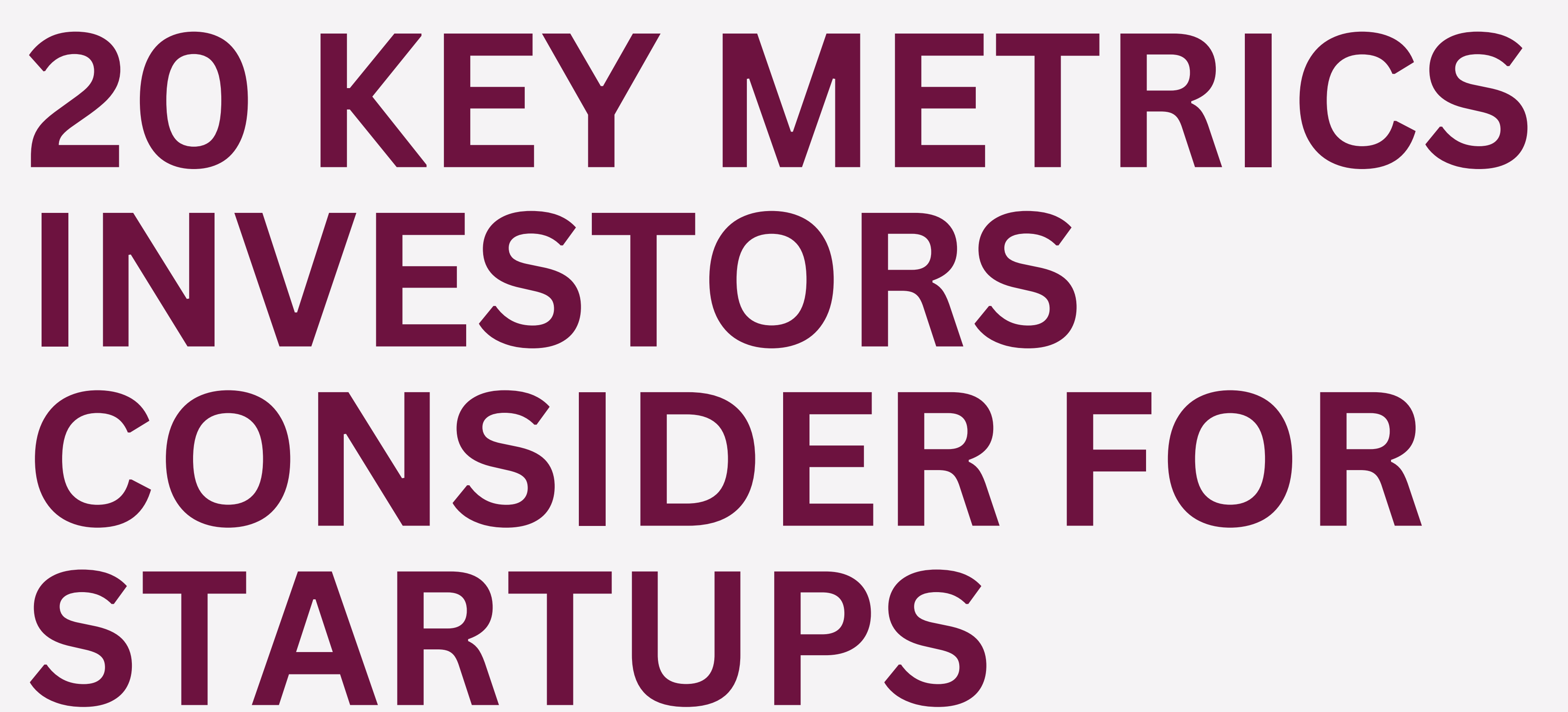

# 20 KEY METRICS INVESTORS CONSIDER FOR STARTUPS

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# Introduction

This e-book summarises 20 key metrics that VCs and investors use when evaluate startups.

It is not meant for educational purposes and simply serves as a guide to understanding the terms and their impact in the ecosystem.

# 1. Accounts Receivable Turnover

Accounts receivables (AR) represents the credit sales of a business, which are yet to be collected from its customers.

Some of the risks associated with carrying a large AR balance include the fact that while the company's revenue may be boosted, there will be limited cash flow thereby affecting the company's ability to meet up with its obligations. Furthermore, where the AR remains uncollected for a long period of time, it runs the risk of being written off as bad debt.

This happens when customers who purchase on credit go bankrupt or are unable to pay their invoice for some other reason.

AR turnover gives an indication to investors on how long it takes a business to collect money from its customers. The business model can look risky if there are many defaults and slow AR turnovers.

# 2. Active users

Active users summarise the saying "the customer is king". Regardless of how phenomenal your business idea is, customers (users) are the ones who truly decide whether your startup will get an investment from Venture Capitalists (VCs).

User analytics can provide a realistic snapshot of your business perspectives even in the early stages. They define product/market fit, a product's stickiness, upcoming marketing initiatives, prospective income, and, as a result, the possibility that investments will pay off and multiply.

The active users can be classified into daily active users (DAU), weekly active users (WAU) and monthly active users (MAU), depending on the industry and vertical the startup belongs to.

- DAU – common for daily-use apps like social networking, email, gaming, specific health and educational apps.
- WAU – typical for apps and productivity or analytical software that are utilized on a weekly basis.
- MAU – used for various B2B tools (security, accounting, etc.) utilized a few times a month or even less frequently.

# 3. Annual recurring revenue

Annual recurring revenue (ARR) measures the amount of recurring revenue a business earns over the course of a year from customers. For forecasting purposes, ARR is used to predict annual recurring revenue for the year, assuming there are no changes to the company's customer base.

Things to exclude from the ARR include set-up fees, credit adjustments, non-recurring add-ons and one-time charges.

ARR is usually contrasted with Monthly Recurring Revenue (MRR). However, while MRR measures the recurring revenue generated each month, ARR measures the recurring revenue generated over the course of a year.

Furthermore, ARR is typically used for Software as a Service (SaaS) businesses that deal primarily in annual contracts. If monthly subscriptions make up the bulk of the recurring revenue, an MRR is a better computation method.

Consequently, an easy way to compute the ARR is to multiply the MRR by 12 months with the formula: ARR = MRR x 12.

ARR remains a good metric for measuring progress and forecasting future growth as amongst other factors, it represents the amount of revenue a company anticipates would recur in a year.

# 4. Average revenue per user

Average revenue per user (ARPU) indicates the amount of money a business may anticipate making from an individual user. In order to properly arrive at the ARPU, the startup must know the total revenue during a giving period (a month or year, depending on the business model) and the total number of paying customers during that same time period.

A month is the most common time period for calculating ARPU because most subscription-based companies utilise a monthly billing plan.

Consequently, the ARPU for that sort of business is computed by dividing the company's total revenue by the number of active subscribers/users within that month (free trial users are not measured with this metrics).

$$\text{ARPU} = \frac{\text{Total revenue during set period}}{\text{Number of active users during set period}}$$

The ARPU gives an investor an indicator of how much money the startup is earning, on average, from each user in a given time frame. However, ARPU can be considered a trend metric.

It is therefore more crucial to monitor the trajectory and make sure it is steadily rising. High churn is indicated by a fluctuating or declining ARPU, which inhibits up- and cross-selling and new customer growth.

# 5. Break-Even Point

The break-even point (BEP) is the point at which the startup's costs of production and total revenue are equal, meaning there is no loss or gain and the company has "broken even".

The BEP is frequently a precise sales goal that will enable the business become profitable and meet its costs. The company can also base its BEP on other presumptions, such as decreased market costs, economies of scale, and increased production efficiency.

# 6. Burn rate

Burn rate represents the rate at which an unprofitable company is spending money and depleting its cash reserves. It is a synonymous term for negative cash flow and is typically calculated in terms of the amount of cash that the company is spending per month. Thus, if a company has a burn rate of $5,000, it means the company is spending $5,000 monthly.

There are 2 types of burn rates: gross burn rate and net burn rate.

The gross burn rate measures the company's operating expenses and is computed by dividing the cash reserves by the total operating expenses, usually on a month by month basis.

$$\text{Gross Burn Rate} = \frac{\text{Cash}}{\text{Monthly Expenses}}$$

Net Burn Rate is the rate at which a company is losing money. It is calculated by subtracting its operating expenses from its revenue and is measured on a monthly basis. It shows how much cash a company needs to continue operating for a period.

$$\text{Net Burn Rate} = \frac{\text{Cash}}{\text{Monthly Expenses}}$$

A high burn rate implies that a startup is rapidly exhausting and suggests that there is a greater chance that it will experience financial trouble. Investors may therefore consider giving the startup more funds to enable it reach profitability or set aggressive deadlines for the startup to generate revenue.

# 7. Churn rate

Churn rate, also referred to as customer churn, is the rate at which customers or subscribers stop transacting with a business. A simple way of looking at it is to classify it as the customers who stop patronising the business or subscribers who canceled their subscriptions within a given time period.

The higher the churn rate, the more customers a business loses.

Conversely, the less churn a startup has, the more customers it keeps and the better for the business.

Thus, for a company to expand its customer base, its growth rate must exceed its churn rate.

In order to calculate the churn rate percentage, we determine the number of customers at the start of a period and confirm the customers lost within that timeframe. For instance, we can evaluate the time period on a monthly basis. We then divide the number of customers lost at the end of the month by the total number of customers at the beginning of the month and multiply it by 100.

The formula can be represented as

$$\textbf{Churn rate} = \frac{\text{number of customers lost at the of the month}}{\text{Number of customers beginning of the month}} \times 100$$

Importance: a high churn rate indicates that the company may be losing revenue which could affect the bottom line. This would be of concern to the investor, and it might question the stickiness of the startup’s business model as it is virtually impossible to scale if a business is churning too many users.

# 8. Customer Acquisition Cost

Customer Acquisition Cost (CAC) is the total sales and marketing costs a startup spends to acquire a new customer over a given period.

The total cost of sales and marketing includes all salaries, bonuses, commissions, programs and overheads associated with attracting and converting a new customer. It is calculated by dividing the company's marketing spend by the number of new customers acquired.

The formula for computing CAC is:

$$\text{CAC} = \frac{\text{cost of sales + cost of marketing}}{\text{new customers acquired}}$$

It is important for a company to determine its acquisition cost as a product that may appear profitable, taking into consideration the operating costs required to produce it, may end up not being profitable if customers will not readily purchase the item.

Related to the the acquisition cost is the ability to retain the customers. If it takes a lot to acquire a customer who then eventually is not retained, it could be problematic for the business.

However, a high retention rate can make a good argument for the CAC and would be deemed less risky for investors if there is steady repeat business.

Consequently, if acquiring customers leads to an imbalance in the profit and loss for the company, it may have to explore certain measures to deal with this trend or investors will be concerned about the growth possibilities.

# 9. Customer concentration risk

Customer concentration risk (CCR) is the level of revenue risk a company has as a result of relying on a small pool of customers. It is the revenue of the company’s largest client(s) relative to its total revenue. Thus, the bigger the client(s), the greater the risk the company’s revenue holds.

A formula that is used to determine if the customer concentration is to high follows the following steps:

a) Identify the top customer and the amount of revenue earned from it over the preceding year;

b) Divide that amount by the total revenue for that year;
c) Multiply that number by 100.

$$\text{CCR} = \frac{\text{top customer's revenue}}{\text{total revenue}}$$

Having high CCR in a few clients can be detrimental to the business as losing that client can erode cash flow, revenue and profit. It could also affect the ability of the startup to negotiate for price increments as it would be under constant fear that the key customers could walk away and affect its margins.

Investors will also find this sort of company unattractive, or they could reduce the valuation of the company on the basis of the high CCR.

# 10. Deferred revenue

Deferred Revenue (also called Unearned Revenue) is money received in advance for goods and/or services that are going to be performed in the future and have not yet been delivered or completed.

In accrual accounting, revenue is only recognized when it is earned. Accordingly, if a customer pays for goods/services in advance, the Deferred Revenue is mot reported on the income statement until it is earned.

Rather, it is recorded as a liability on the balance sheet as technically, it is payment for goods/services still owed to customers. When the income is later earned, the liability is recognized as income.

Companies are required to record deferred revenue due to the accounting principles of revenue recognition. Consequently, the timing of the payment by the client is ignored and the revenue is recognised only when it is earned.

Investors value deferred revenue as it sheds light on a company's financial situation.

It helps investors understand how much cash a company has already received in advance and how much revenue is yet to be earned.

# 11. Growth rate

Growth rate describes the rate of change in the value of a specific metric across a given time period, expressed as a percentage. Depending on whether the size of the variable is rising or decreasing over time, growth rates can be positive or negative.
The churn rate and growth rate are diametrically opposite variables as while the former measures the loss of customers, the latter measures the acquisition of customers.

A good approach to adopt when determining the growth rate is to compare its new subscribers and its loss of subscribers in a specific period.

If the growth rate (percentage of new subscribers) is higher than the churn rate (percentage of lost subscribers), the company experienced growth. However, where the churn rate is higher than the growth rate, the company will be deemed to have experienced loss in its customer base.

The following formula can be used to calculate the growth rate across two periods.

Growth Rate (%) = (Ending Value ÷ Beginning Value) – 1

For instance, if a company's revenue was $50 million in 2021 and grew to $100million in 2022, its year-over-year (YoY) growth rate is 100%.

**Growth Rate = ($100 million ÷ $50 million) – 1 = 1, or 100%**

Investors will prefer a positive growth rate as it would be deemed to represent the compounded annualized rate of growth of an investment, or a company's revenues, earnings, or dividends.

# 12. Gross merchandise value

Gross Merchandise Value (GMV), sometimes referred to as Gross Merchandise Volume, is a metric that measures the total amount of sales a company makes over a certain period of time. It is usually measured per quarter or once a year.

It's a metric that is commonly used in the eCommerce industry and is calculated before accrued expenses associated with the sale of products (such as costs delivery, discounts, advertising and returns) are deducted.

GMV is a good indicator of growth as it measures the volume and value of merchandise sold or the number of transactions handled. A simple way of calculating GMV is to multiply the price charged by the number of goods sold:

**GMV = Sales Price of Goods x Number of Goods Sold**

For instance, if 20 products are sold at the rate of $5000 each, **the GMV would be $5000 x 20 = $100,000**

However, while GMV is valuable for determining a rough estimate of company earnings, it only offers raw data that doesn’t accurately reflect the underlying value of the products being sold or the profitability of the company. business profitability. It therefore should be used with other metrics to determine the true revenue and financial state of the company.

# 13. Gross profit

Gross profit is the income a business generates after subtracting all the direct costs involved in manufacturing and selling its products or services.

Cost of goods sold (COGS) is subtracted from total sales to determine a company's gross profit. The business includes all products sold during a financial period in its calculation of total sales.
Gross profit is important as it reflects how efficiently an organization utilizes labour and supplies for manufacturing goods and services to clients.

It enables the business ensure that its costs does not become excessive and helps it identify the impact to the business as cost increases.

So, as COGS rise in value, the gross profit value falls, leaving the business with less cash to cover operating costs. On the other hand, if COGS falls, the profit will rise and the company will have more cash on hand to support its operations

# 14. Lifetime value

Lifetime value (LTV), also known referred to as customer lifetime value (CLV), is a metric that represents the total revenue or profit a company can expect to generate from a customer over the entire duration of their relationship with the company. It is a forward-looking metric that considers the potential value of a customer beyond their initial purchase.

The concept of LTV is important because it helps businesses understand the long-term worth of acquiring and retaining customers.

By estimating the value a customer delivers over their lifetime, a company can make informed decisions about CAC, marketing strategies, customer service investments, and overall business growth.

The formula for calculating LTV can vary depending on the business model and industry, but a basic common formula is:

**LTV = (Average Purchase Value) x (Purchase Frequency) x (Customer Lifespan)**

For instance, if a customer typically spends $50 per purchase, makes an average of 5 purchases per year, and remains a customer for 5 years, the LTV would be:

**LTV = $50 x 5 x 5 = $1,250**

This means that, on average, this customer is expected to generate $1,250 in revenue over their entire relationship with the company.

By understanding the LTV of customers, businesses can allocate their resources more effectively, identify high-value customer segments, tailor their marketing and retention efforts, and ultimately improve their profitability and customer satisfaction.

LTV is also important to investors as it provides a valuable measure of a company's potential profitability,

growth potential, and customer acquisition efficiency, aiding in assessing the financial health and investment value of the business.

# 15. Monthly Recurring Revenue

Monthly Recurring Revenue (MRR) is a financial metric for businesses that have a subscription-based or recurring revenue model. It represents the total predictable and recurring revenue that a company expects to receive on a monthly basis from its active customers. MRR typically includes subscription fees, ongoing service charges, or any other recurring revenue streams.

It is usually contrasted with Annual Recurring Revenue (ARR) as while the ARR measures the yearly value of the company’s revenue, the MRR measure the monthly value.

MRR is arrived at by summing up the revenue generated from all active subscriptions or recurring sources within a given month. It provides a snapshot of the company's revenue stream and its ability to generate consistent and predictable income over time.

To calculate the MRR, you multiply the number of monthly subscribers by the average revenue per user (ARPU).

**MRR = Number of subscribers under a monthly plan x ARPU**

For instance, if a company has 5 subscribers on a $300 a month plan, the MRR will be:

**5x $300 = $1500**

MRR remains a key performance indicator for subscription businesses as it provides visibility into the company's revenue stream, helps track growth, and facilitates financial planning and forecasting.

# 16. Net profit

Net profit is the amount a business keeps after deducting all taxes, interest, and overhead expenses for a given time frameselling. In order to determine the net profit, the company’s gross profit has to be determined and where the value of the net profit is negative, it will be regarded as net loss.

For the investor, the net profit is crucial as it determines whether the business is headed towards profitability and is breaking even. Investors will also look at the company's net profit to determine whether it can afford to pay off its obligations in the future.

Where the net profit is low, or appears as net loss, the investor may be reluctant to invest.

# 17. Net promoter score

Net Promoter Score (NPS) is a customer loyalty metric that measures the willingness of customers to recommend a company's products or services to others. It is commonly used to assess customer satisfaction and gauge the overall sentiment towards a brand.

NPS is usually determined by a survey where customers are asked to rate, on a scale of 0 to 10, how likely they are to recommend the company to others. Based on their responses, customers are classified into three categories:

- Promoters (score 9-10): These are customers who are highly satisfied and are likely to recommend the company to others, contributing positively to the company's growth.

- Passives (score 7-8): These customers are relatively satisfied but are less likely to actively promote the company. They may be susceptible to competitive offerings and might not exhibit strong loyalty.

- Detractors (score 0-6): These customers are unhappy and dissatisfied. They may actively spread negative word-of-mouth about the company, potentially impacting its reputation and growth.

To calculate the NPS, the percentage of detractors is subtracted from the percentage of promoters. The resulting score can range from -100 to +100, with higher scores indicating a higher proportion of promoters and a more positive overall sentiment.

NPS serves as a useful measurement for assessing customer loyalty, satisfaction, and advocacy. It helps companies prioritize customer-centric initiatives, improve customer experience, and drive long-term growth.

# 18. Viral growth

Viral growth refers to the rapid and exponential expansion of a product, service, or content through viral marketing techniques and social sharing. It occurs when users enthusiastically share the offering with their networks, leading to a cascading effect of adoption and awareness.

Characteristics of viral growth include exponential user acquisition, organic reach, network effects, low cost per acquisition, enhanced brand awareness, as well as high engagement and retention.

This increased visibility and brand awareness can attract the attention of potential customers, investors, and media outlets, contributing to the overall success of the startup. Viral growth often results in a self-sustaining cycle where each new user brings in more users, amplifying the overall growth rate.

Viral growth can be quantified with what's called the k-factor, which is defined as: **"how many new users a user brings to your product in a defined time period."** 1 user = k new users.

To achieve viral growth, startups can focus on creating a product or content that is remarkable, easily shareable, and provides a compelling value proposition. Incorporating social sharing features, incentivizing referrals, or leveraging influential individuals can also stimulate viral growth. Monitoring key metrics such as reach, social shares, engagement, and conversion rates helps assess the success and impact of viral growth strategies.

# 19. Total addressable market

Total Addressable Market (TAM) represents the total market demand for a specific product or service. It quantifies the maximum revenue opportunity available to a company or industry if they were to capture 100% market share.

TAM takes into consideration the entire market space that a company's product or service could potentially target, regardless of the current competition or market penetration. As a result, it helps businesses assess the size and attractiveness of the market they operate in or plan to enter.

Calculating TAM involves determining the total number of potential customers or units that could benefit from the product or service and multiplying it by the average revenue per customer or unit. This provides an estimate of the revenue opportunity that exists within the market.

However, even the investor is aware that TAM represents the **maximum market opportunity** and does not consider factors such as market segmentation, competition, or market share.

To obtain a more realistic estimate of a company's addressable market, businesses often consider other factors such as **serviceable addressable market (SAM) and the serviceable obtainable market (SOM)** to account for specific target segments and achievable market penetration.

# 20. Serviceable obtainable market

The Total Addressable Market (TAM), and the Serviceable Available Market (SAM) and the Serviceable Obtainable Market (SOM) are interrelated.

While the TAM represents the total market the total market demand, SAM refers to the specific portion of the TAM that a company can realistically target and serve with its products or services. SAM represents the subset of the market that aligns with a company's value proposition, resources, and capabilities.

It considers various factors that may limit a company's ability to address the entire TAM such as geographical limitations, target customer segments, industry-specific requirements, regulatory constraints, or resource constraints.

Conversely, the SOM, also referred to as target market share (TMS), is a percentage of the SAM that the company is able to successfully penetrate and acquire customers from.

SOM would consider factors such as the company's resources, capabilities, competitive advantages, and market positioning that enable it to effectively target and capture a specific segment of the SAM. It represents the portion of the market that the company can realistically obtain and generate revenue from.

By focusing on the SOM, a company can develop tailored strategies and allocate resources to maximize its market share and revenue within the specific segment it is targeting.

This approach allows for a more targeted and efficient use of resources to achieve sustainable growth and profitability.

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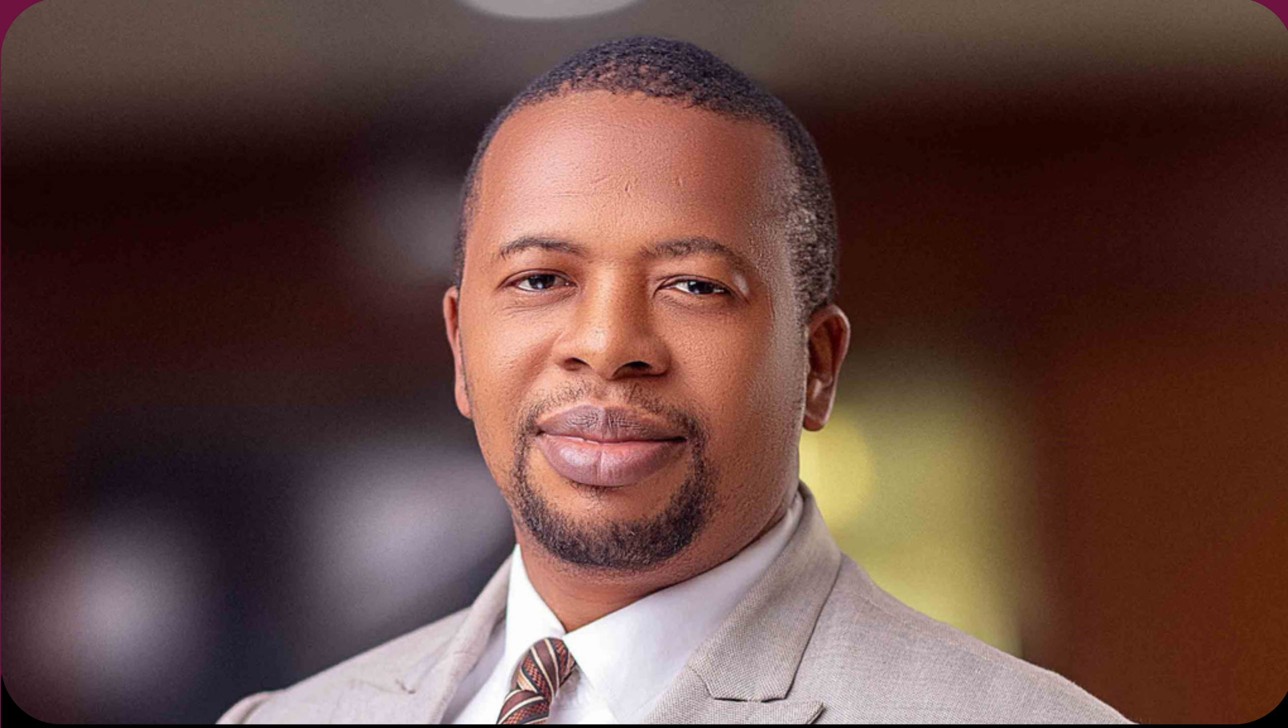

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