MONEY 20/20
AN ASCENTIAL COMPANY

WELCOME TO THE AGE OF CENTAURS

BY SANJIB KALITA

Aileen Lee, founder of Cowboy Ventures, captured lightning in a bottle 9 years ago when she coined the term Unicorn to describe startups that had achieved $1 billion valuations. Over the past decade, founders aspired to become unicorns and the term has become a badge of success in multiple industries. The word unicorn indicates rarity and alludes to their magical nature. Nine months ago, Bessemer Venture Partners highlighted a new tech milestone for cloud businesses; unicorn vs centaur. I submit that after a decade of the unicorn era, we are, in fact, entering the era of centaurs across startups.

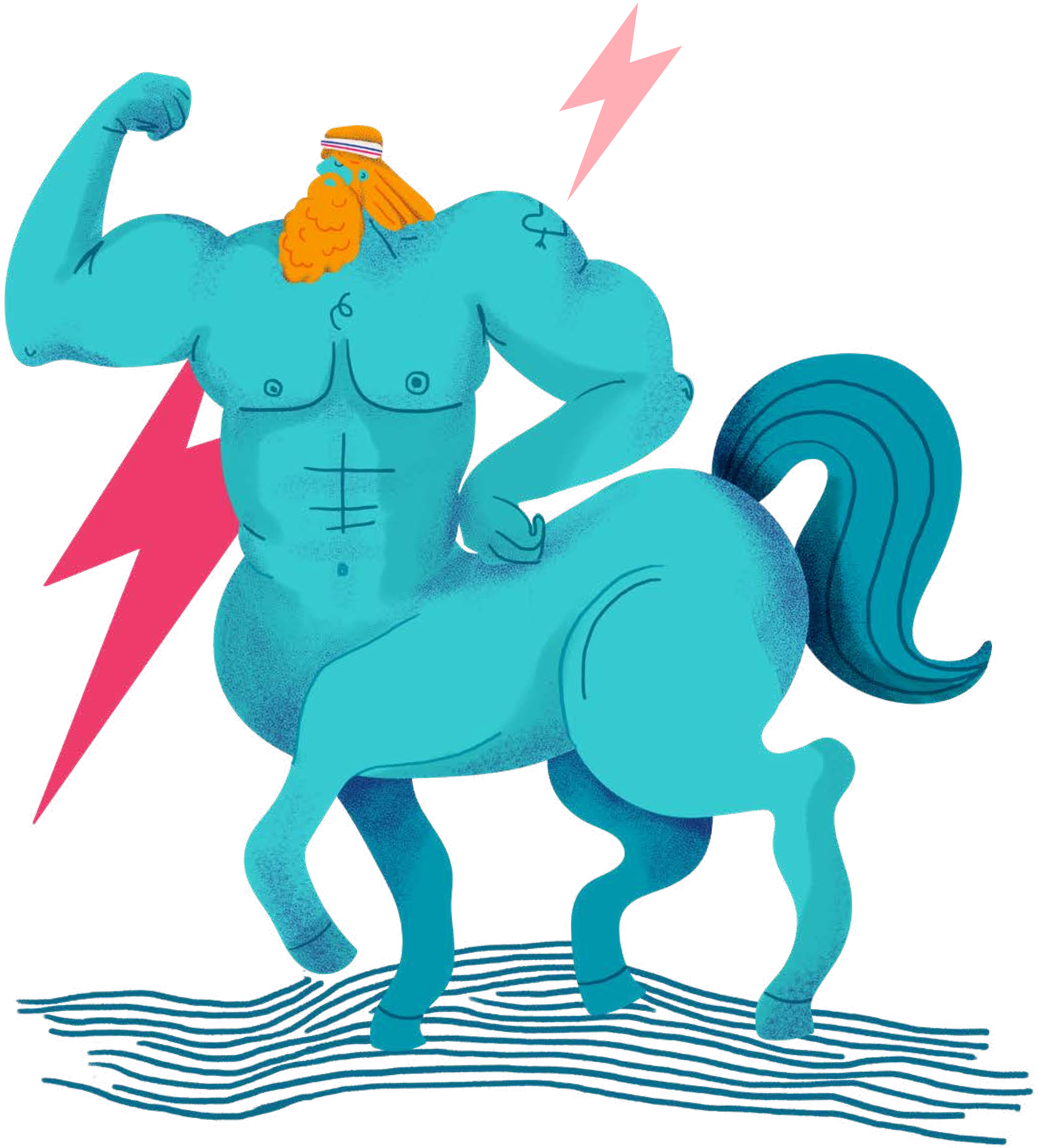
Like any mythology, Unicorns thrived in a financial economic market era that was not grounded with reality. For the last 12 years we have all been subject to a huge financial experiment which unlike a fairy tail place was called quantitative easing or fiscal stimulus. This experiment, executed on a massive scale by governments around the world, had never been attempted before. One major by-product was an environment where unicorns could thrive. Why? Capital has never been as cheap as through this period and is very unlikely to ever be this cheap again. For some, fiscal stimulus created a financial system underpinned by make believe money.

Just as a unicorn's one horn signaled its power and magic, a one billion dollar valuation achieved by a startup signaled power and magic that would take it even further. Unfortunately the collapse and valuation reduction of many unicorns, as the world realizes how precarious this fiscal stimulus world was, globally demonstrate the shortcomings of focusing on valuation alone. Rather than looking for a one (Uni) billion dollar valuation, firms should be looking for one-hundred (Centi) million dollar annualized revenue or even better companies that can show a firm path to profit and positive cashflow.

UNICORNS

Unicorns are benevolent creatures, often depicted in soft focus with rainbows and waterfalls. Their loving, passive, and cuddly demeanor perfectly matched consumer-facing startups creating fun interfaces to spend (waste) time on. Unicorn company employees were treated to perks such as free food on par with high-end restaurants, concierge services to manage their daily chores, health care and gaming facilities to bring out their inner teenagers, and cultures that encouraged experimentation and free thinking.
For people coming from traditional workplaces, it was truly a fantasy land where finding unicorns lazing about wouldn't raise a question.

Valuation was the key metric for the past decade. From a corporate financial perspective, unicorns used higher valuations to access low-cost capital and fund further growth. Higher valuations signaled prospective employees, partners and investors that this company was on the right track. This flywheel effect was theoretically coupled with the health of the core business. Investors, who sparked the flywheel, knew that they would be able to cash out with acquisitions or public offerings.



CENTAURS

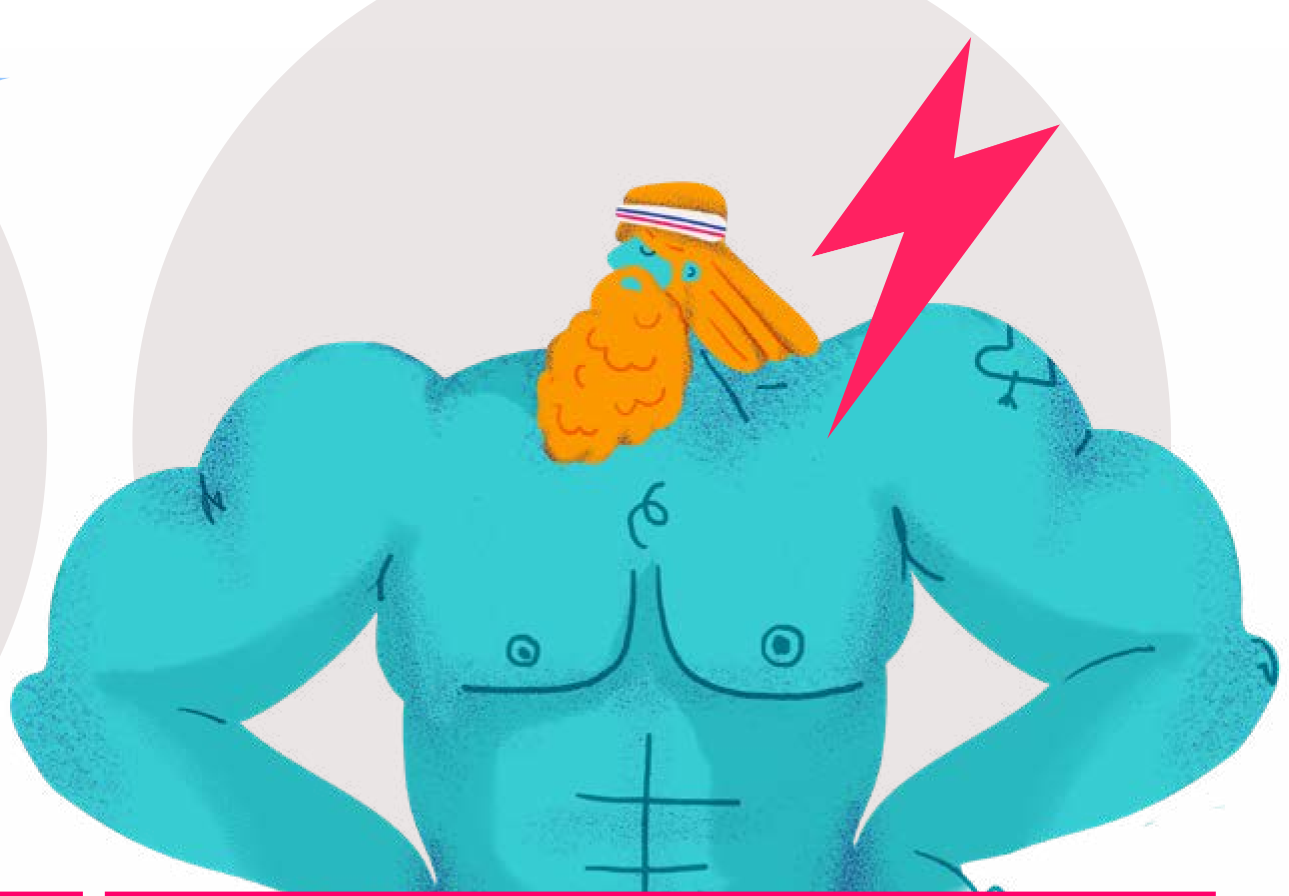
Centaurs are irritable creatures, often depicted with aggressive poses and warlike settings. Whereas unicorns bring visions of the sky and air, centaurs are of the earth. A centaur is a creature with the upper body of a human and the lower body and legs of a horse. While Unicorns evoke white collar images, Centaurs are very blue collar, if in fact they have any collar at all! Unicorns evoke images of sky-high valuations while Centaurs evoke images of hard-fought gains from the ground. The hardest fought gains on the ground by startups are typically revenue. $100 million in revenue is a challenging goal that is often accompanied by battle scars and captivating tales of battles won and lost.

Revenue where operating leverage will quickly move a business to profit is the key metric that entrepreneurs should be focusing on on the road ahead. While valuation is negotiated by a startup with a single investing entity, revenue is the summation of numerous transactions with individual customers. Achieving $100 million in revenue with a clear path to profits is a milestone every bit as worthy as a 1 billion dollar valuation, and in fact significantly better.

One Billion Dollar Valuation Vs. One Hundred Million Dollars In Revenue

From a corporate finance perspective, the move from valuation (unicorns) to revenue (centaurs) changes focus from the balance sheet to the income statement. The balance sheet equation is that assets equal liabilities plus equity. The income statement equation is that revenues minus costs equals net income. The balance sheet is a snapshot at a single point in time. The income statement is over a period of time, typically one year. Fooling the balance sheet is like sucking in one's gut during a photo session - relatively easy! Fooling the income statement is like not eating pizza and ice cream a couple of weeks before a blood test - harder and
less likely to hide true results!

Recently an entrepreneur who invested $25k to begin building a company two years ago told me that their Year 2 revenue was $5 million, which was amazing. She needed to further invest in her company's capabilities to reach the next level and asked whether she should try to raise several million dollars or whether she should focus on growing revenue by a couple of million dollars. As all entrepreneurs know, time is limited and focusing on one goal will impact others. I told her that if she were asking me this question a year or two ago, I'd tell her to focus on fundraising. But in today's environment, growing revenue and fortifying the sales pipeline and building revenue is a better use of her limited time.

UNICORN	CENTAUR
	
PHYSICAL COMPOSITION	**PHYSICAL COMPOSITION**
Horse with a single horn on head with potential magical properties	Top half of a human, lower half and legs of a horse
DEFINITION	**DEFINITION**
1+ Billion-Dollar Valuation	100+ Million Dollar Revenue
KEY VALUE PROPOSITION	**KEY VALUE PROPOSITION**
Magical user experiences and capabilities	Intelligence combined with execution capabilities

WHY REVENUE IS THE RIGHT METRIC IN THE NEW ERA

Focus: Are you building an exit door or a house?

All startup builders know the extreme demands on time and resources. While options on what to create and how to build are endless, reality forces teams to focus on what will be most impactful. With many paths to growth, the most valuable startups begin from a core of serving the unmet needs of specific customer segments. They build a house that makes customers feel warm, safe and happy inside. This is also what customers seek, so all interests are aligned.

No matter how well one plans, fundraising inevitably reduces focus on business building for months. The focus of investors is to get the business to an exit quickly with the greatest valuation to deliver a huge ROI. Theoretically, valuation should be proportionate to how the business serves its customers, but that isn't always the case. In their ideal world, many investors would build exit doors, not houses.

So as a member of the startup team, what do you build? During the past few years, and whenever markets get frothy, building a shoddy house had no downside, as there were plenty of buyers for anything resembling a house. Over the next few years, expect housing inspectors to be pickier. The best strategy is to build a house for your customers.

Scalability: Do You Want To Drink From A Firehose Or A Glass?

While I respect and enjoy hearing Reid Hoffman's thoughts, I felt uncomfortable whenever Blitzscaling was talked about in a manner that applied to every startup. According to HBR, Blitzscaling is "the science and art of rapidly building out a company to serve a large and usually global market, with the goal of becoming the first mover at scale." With this thinking, if a bit of water from a glass would quench the thirst for startup growth, a lot of water from a firehose would be even better. VC firms such as Softbank used a strategy of investing massive amounts of capital into firms so that they crowded out all other competitors.

But drinking from a glass is radically different from drinking from a firehose, which many startups weren't ready for. While scaling is still a necessity for startup success, scale for scale's sake is a folly. Building revenue through the sales process is intertwined with operations. Inevitably this exposes shortcomings in the business which need to be addressed with capital. At that point, it does make sense to plan for growth. But too many startups drank from the firehose because they could or were forced to, leading to many muddy situations and several drownings.

Network Effects: Mainframe Thinking Or Smartphone Thinking?

Cash from a single customer is usually magnitudes smaller than from a single investor. Both entities become vested in the startup's success- thus become part of the support network. The support network is important because it provides credibility, guidance and accelerates growth. The magnitude of investors a company has is typically in the 10's. The magnitude of customers a B2B startup has is typically in the 10's or 100's. The magnitude of customers a B2C startup has is typically in the 1,000's to millions. This means that at a given scale startups could potentially have hundreds, thousands or millions more customers than investors.

Network members are references for others thinking about being investors, customers, or employees. When prospects seek out references, they can speak to people in other categories but are most likely to value ones in their own category. In other words, a prospective investor might speak to customers or employees but will often place greater weight on existing investors. Now think about frequency of fundraising vs. frequency of making a sale. Fundraising decisions happen once every 18-24 months whereas sales decisions to business happen 18-24 times a year and many more for consumers. That means that sales networks can help 30-50 more times than investors.

Since there are fewer businesses than consumers and fewer investors than businesses, each opinion has different impacts. Nonetheless, it's a bit like thinking about the positives and negatives of mainframes vs. smartphones. Sometimes, it's better to have a highly concentrated system like a mainframe, but other times, a distributed system gets used more often and solves problems faster and in a more personalized manner.

Profitability: An Attainable Goal Or A Zombie Nightmare

Businesses without profits and positive cash flows have built-in death dates once their capital runs out. During the unicorn era, easy access to capital in both the debt and equity markets enabled businesses to postpone death dates. Profitability is a very dynamic metric, highly dependent on company stage, sector and business model. For example lending businesses can generate windfall profits if the risk tolerance is there to weather economic downturns, whereas payments businesses tend to be more consistently profitable, but generate smaller returns on capital.

Early stage businesses are typically unprofitable, but per-customer financial metrics shouldn't be too much of a horror show. Coupled with outstanding customer growth and engagement, this makes a good case for further investment. Profits are nice to have, not a must have at this point. Growth stage businesses should see solid and ideally increasing per-customer profitability. Customer growth could be plateauing a bit, which makes the case for capital. Late stage businesses should be profitable in aggregate, which coupled with other metrics, could be cases for them to be strong stand-alone entities, or strategic opportunities for other firms.

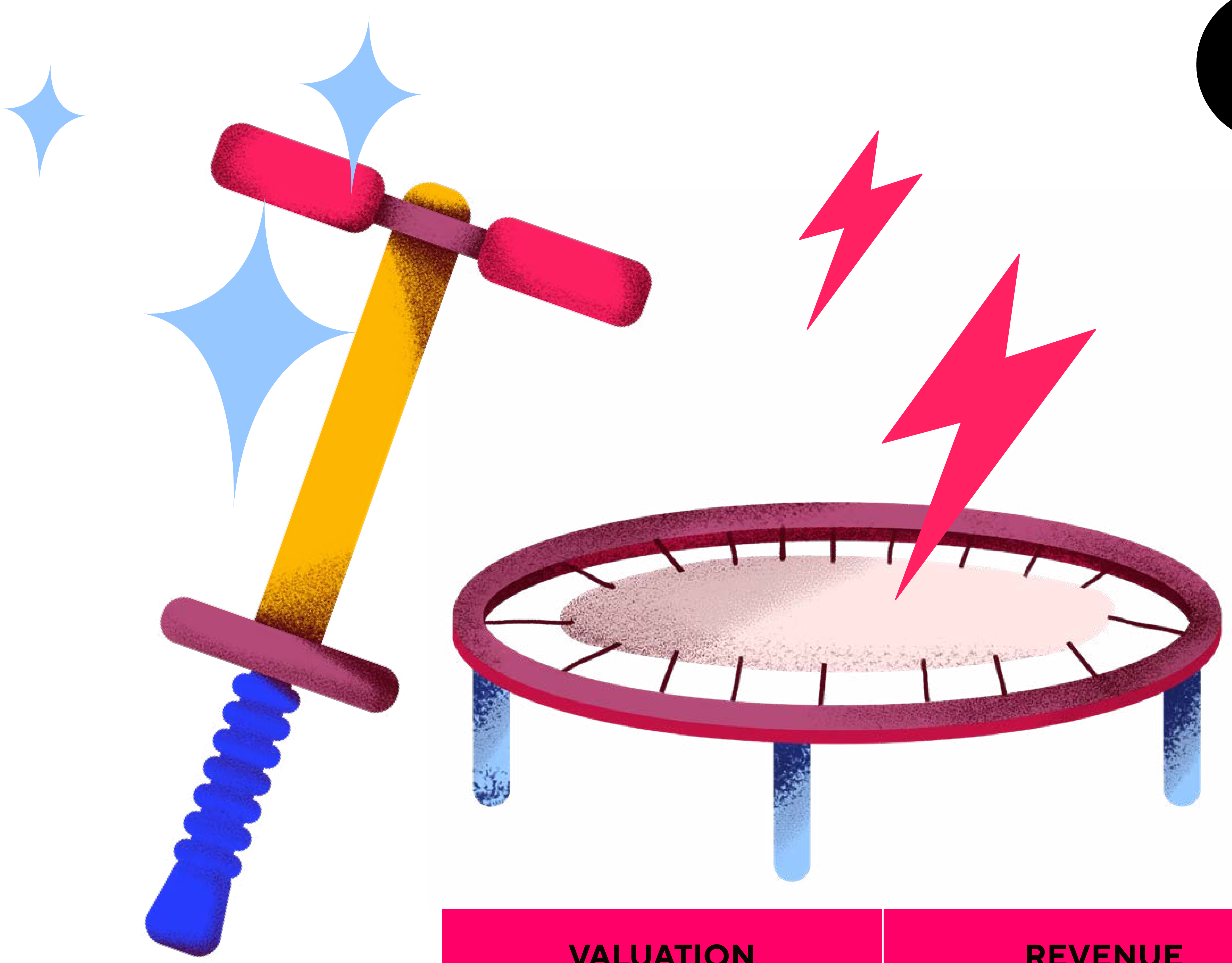
During the unicorn era, both startups and investors altered the natural dynamics of businesses. Easy access to capital enabled firms that should have died to continue on in a zombie-like state.

Firms accelerated growth in order to continue to access capital with decreased vigilance towards profitability. In some cases, it caused businesses to grow beyond the size of their markets. In other cases, it caused firms to grow a bad business to huge scales. The proliferation of companies living beyond natural death dates forced potentially healthy companies to make decisions leading to zombie-markets. Firms that went against that trend should hopefully be able to reap the benefits of profitable growth in the new era as the zombie-unicorns fall by the wayside.

Resilience: The Pogo Stick Or The Trampoline

While the startup ecosystem is abnormally (unhealthily) more positive than the general economy, things usually don't happen according to plan. In fact, they rarely do. Successful startups deftly adapt to changes and find new paths to success. To keep up with the twists and turns, startups need to be confident any motion downward will be met with a larger bounce upwards, like riding a pogo stick. When they listen to people on the sidelines saying things like, "What if you fall?", the response is often that they "Just don't get it." This is partially driven by a "fake it till you make it" mentality, but also a lack of awareness and potentially arrogance.

With a less buoyant economy, startups experiencing downwards motion have fewer opportunities to bounce back. Oftentimes, large investments created tremendous pressure to spend the investment quickly rather than efficiently. While confidence will continue to be a requirement, humility will be necessary from someone on the leadership team to plan for potentially fatal falls. Rather than pogo sticks, they will need to think of trampolines, which have more springs, dampen the fall, and are built for resilience.



	VALUATION	REVENUE
FREQUENCY OF ACTION	Once every 1-2 years	Several times a year (or month)
INTERACTION WITH	Investors	Customers
PRIMARY PARTICIPANTS	10's	100's or 1,000's+
CASH INFLOW AT A SINGLE POINT IN TIME	Millions+	Thousands+
ACCOUNTABLE EMPLOYEES	CEO, CFO	Entire Company

LOOKING AHEAD TO REAL WORLD IMPLICATIONS

So what does this really mean? In the end, aren't unicorns and centaurs both creatures of fantasy, so not connected to the real world? Figments of the imagination and creatures of fantasy can have dramatic effects if they tap into human emotion and psychology. Exhibit 1 is a creature of fantasy who is responsible for consumers spending over twice as much than they do when not there - Santa Claus! Exhibit 2 is all of the companies that desperately tried to become unicorns.

Revenue-based M&A Opportunities:

Companies large and small will be pressing to show revenue growth. While other metrics will remain important, acquisitions that add significant revenue will have particular importance and fetch higher premiums. The incremental revenue could be from selling similar products but to completely different markets. It could also be from different products to similar or the same customers. For companies with account-driven strategies such as banks, there could be justifications based on cross-selling capabilities as well.

Centaur Combinations:

Established companies with deep relationships and strong customer bases will see more opportunistic acquisitions to add intelligence to core businesses. Similar to a half-human, half-horse combination, this will open up opportunities for both. With trends like embedded finance and generative AI, we'll see fintech combine with unexpected industries like retail, telecom, healthcare, travel and many more.

Market Signaling:

In an environment where valuations drive coverage and market perception, the elite VC firms are able to command better terms than their peers. In an environment where revenue becomes a primary driver of market perception, elite customers of startups who can bring large volumes of business will command better terms than their peers.

Marketing & Communication:

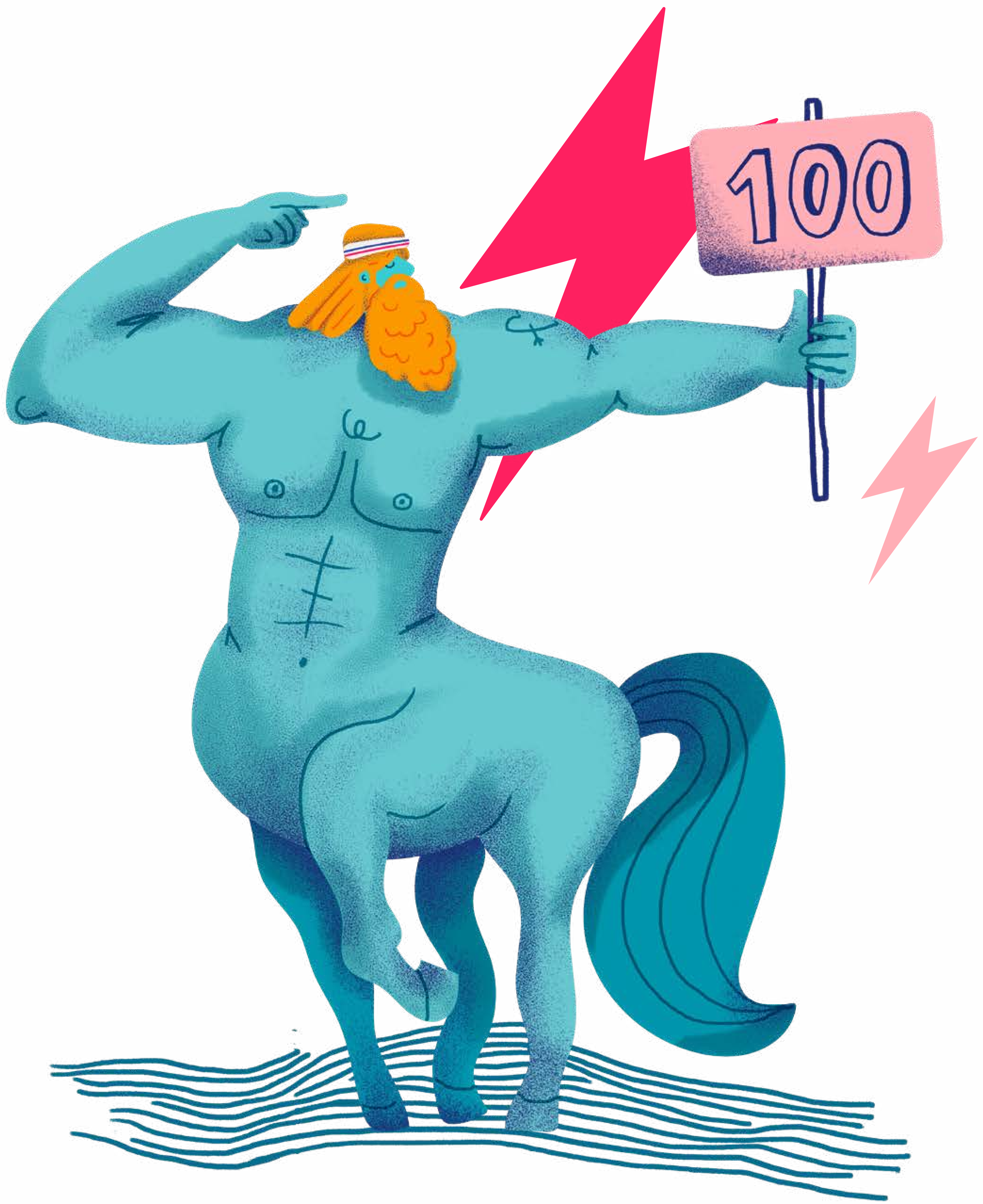
We are moving beyond the world of rainbows, into one where believability will command a premium. With deep fakes, fraudsters and exaggerations gaining mindshare, trust will be challenged from both consumer and business perspectives. Don't sugarcoat your message, as the mindset will shift from what is ideal, to what is fair.

CONCLUSION

Startups will continue to be the place where fantasy attempts to become reality. Obsession with becoming unicorns led to questionable decisions and practices. Startups should now focus on being centaurs. $100 million revenue is the new $1 billion dollar valuation.

The number is smaller and the metric less sexy, but the result is still something that most would say is unbelievable. Company building will focus on creating a solid structure rather than the quickest exit. Scale will continue to be a measure of success, but the metric moves from valuation to revenue.

Networks will gain renewed appreciation from ground support rather than just from ivory towers. And there will be more questions and thoughts around resilience. Looking ahead, the winners will be the ones who are able to keep it at 100!

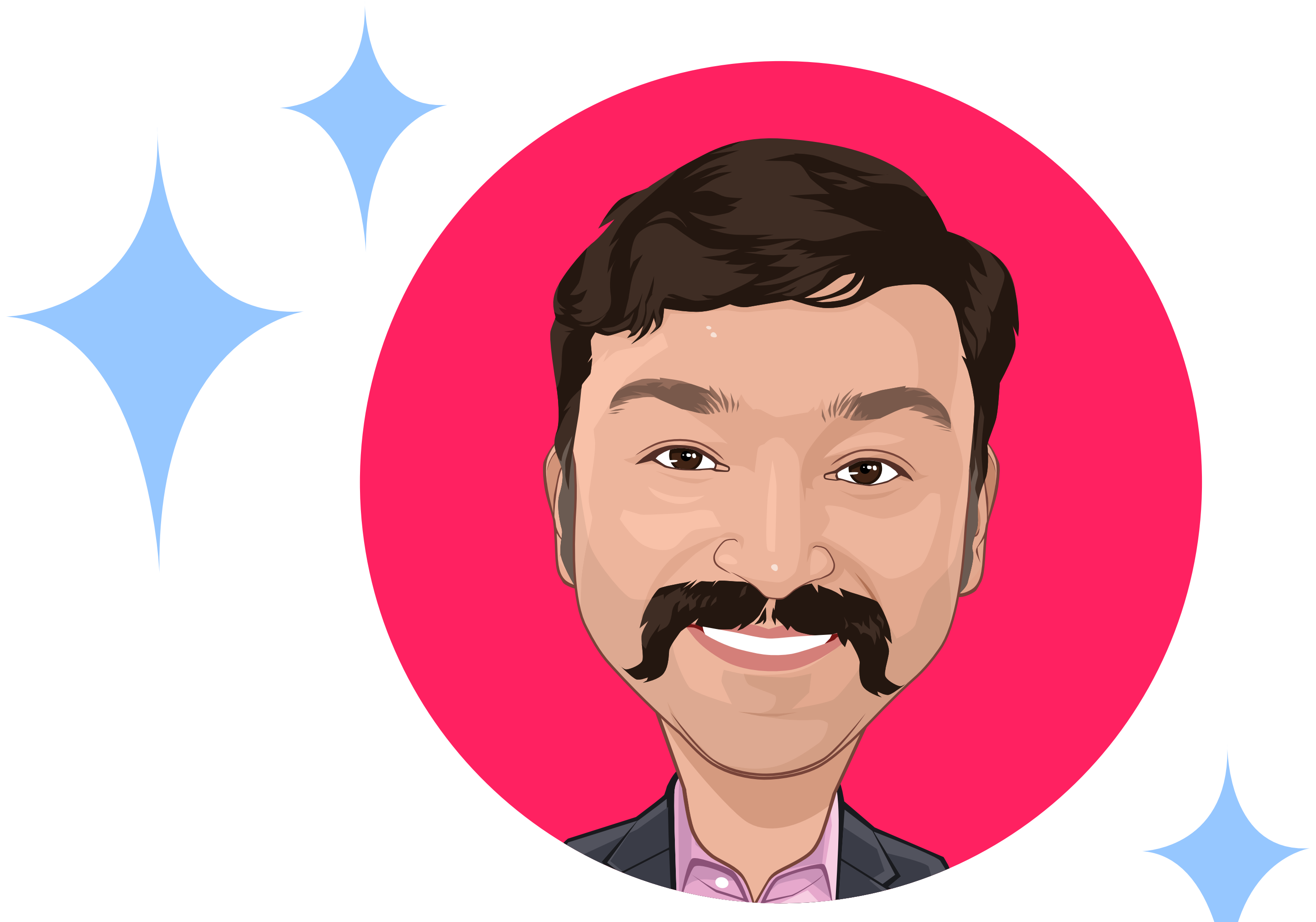


ABOUT THE AUTHOR

Sanjib has been a fintech leader for over two decades. He is The Wizard at Money20/20 which he helped grow from startup to successful exit with his creativity and magic. He is also Founder & CEO of Guppy, a fintech startup focused on credit data control and quality.

He has worked for large organizations like Citi, where he managed one of the largest credit card portfolios in the world, Intel, where he helped launch their graphics chip business, and Google, where he worked on Google Wallet, as well for multiple startups with multiple exits. He is also an investor and advisor of several startups bringing technical innovation to industries including education, healthcare, financial services and retail.

Sanjib has an MBA from the Kellogg School of Management as well as Bachelors and Masters degrees in Electrical Engineering from Cornell University, where among other things, he's built lasers, electric cars, hi-fi audio systems, and AI systems to detect life-threatening arrhythmias.



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