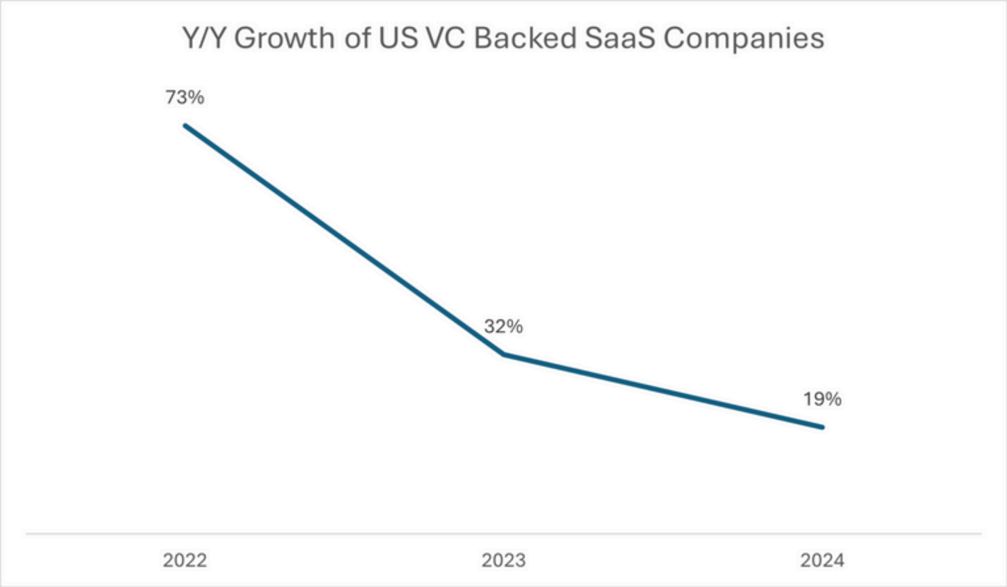
HOW TO 2X THE VALUE OF YOUR BUSINESS

According to McKinsey & Co, companies that achieve the "Rule of 40" are valued at double the revenue multiple of average performing companies. This guide outlines the path to achieving profitable growth.

TekStack

Selling tech has gotten a lot harder in the last couple years.

According to PitchBook, revenue growth of public US VC-backed SaaS companies, the best and biggest, has fallen sharply since 2022. The top cohort were driving growth of 73% year-over-year in Q1 2022. A year later that growth was down to 32%, in 2024 that growth is down to 19%.



And according to data collected by Sales Science, the top cohort of public companies are adding 36 cents of ARR growth from one dollar of sales and marketing spend.

If the biggest SaaS brands in the world are finding it harder to grow, and can't do it efficiently, how are the rest of us supposed to grow, especially without the luxury of a big brand tail wind, big selling teams, or ample cash generated through venture funding or profitability?

This guide is for the rest of us out there.

WHY IS RULE OF 40 SO IMPORTANT?

Cash constrained, resource constrained B2B Technology companies want to grow their business, and do so profitably. No one is denying that there is a ton of competition: Gartner reports the tech industry is still a growing $5 trillion industry.

According to a recent McKinsey & Co. study, technology companies that achieve ‘Rule of 40’ are valued at *double the revenue multiple* of the average performing company. What is the Rule of 40 and why is it the best measure of profitable efficient growth?

RULE OF 40 = Y/Y REVENUE GROWTH % + EBITDA %

Popularized by Brad Feld a decade ago, the Rule of 40 is a metric that states the sum of your year over year revenue growth rate plus your profit margin should exceed 40%.

As an example, a company that has an annual growth of 20% and EBITDA of 20% has achieved the Rule of 40. So has a company with 30% growth and 10% EBITDA, and likewise a company with 10% growth and 30% EBITDA, etc.

For years, technology companies had access to limitless capital and discounted prices. Even if your company didn’t rely on venture backed financing, your competitor probably did, ultimately having an impact on you. Free funding allowed companies to grow top line revenues without consequence to how much cash they burned. However, in the post 2022 tech world, the companies that are rewarded are the ones that can achieve growth without burning cash to do so.

ACHIEVING RULE OF 40

TekStack believes that Rule of 40, or Profitable Efficient Growth is achieved four ways, in order:

1. Improving win rates
2. Increasing the size of your funnel
3. Retaining and growing your customers
4. Protecting your profits

We call this Revenue Performance.

Improve your win rate. This is the first thing you need to fix. Moving your win rate from 20% to 40% is not a 20% improvement in revenue booking. It's a 100% improvement. Win rate has an outsized impact on your Sales Velocity.

Let's say you are a tech company with 20 deals, average contract value of $50K, taking 120 days to close. If your win rate is 20%; your sales velocity is $1,667; or you are on path to closing this much each day. Now, if you can improve your win rate to 35% your sales velocity increases to $2,916; or $1M per year.

The fastest way to improve win rate is to ensure consistency in how you sell. You're losing deals you shouldn't be losing.

Create the right sales motions:

- Targeted Account Selling
- Marketing Lead to Sales Handoff
- Discovery Calls
- Opportunity Qualification
- Call Planning
- Mutual Action Plans
- Managing competitors
- Demonstrations that win
- Services Estimating & Proposal Delivery
- Addressing Objections
- Closing deals

There are key moments for every buyer journey, make sure your sellers are aligning their actions to the buyers.

SALES VELOCITY =

$$\frac{\text{\# OF OPPORTUNITIES} \times \text{WIN RATE \%} \times \text{AVERAGE DEAL SIZE}}{\text{SALES CYCLE LENGTH}}$$

SELL SMARTER

Develop the right selling tools
Make sure your sellers have the right tools to get the job done. Putting the right tools in place will create efficiency for your sellers, and make sure each seller is applying the best practice. Otherwise, they'll just make up their own approach.

- Outbound Prospecting Sequences
- Cold Call Scripts
- Sales Collateral
- Sales Presentations
- Sales Proposals

Consistent & reinforced execution
Help sellers by setting goals and measuring results.

- Calling & Email Activity
- Weekly deal reviews
- Updating buyer activity records
- Updating opportunity information (Close dates, deal values, stages)
- Call Planning, Action Planning, Account Strategies

INCREASE THE SIZE OF YOUR FUNNEL

You don’t want just any deals, you want high fit, winnable deals entering the funnel.

Define your Ideal Customer Profile

Do a win analysis to figure out where you win and where you lose. Interview customers and lost prospects to get the information you need. Define a narrow segment where you are most likely to win. For most companies, to win 10 deals per year, you don’t need a market size greater than 8,000-10,000 accounts.

Often the best way to pick a segment is to focus on demographics like region, size, and/or vertical. But there are other criteria as well like technographic (what technology are they running), and psychographic (are they an early or late mover on technology adoption?)

Hone your Message

Buyers are faced with a sea of options. The status quo can sometimes be the safest option of all. In the face of increasing competitive pressure, how does your company stand out from the rest? More and more companies are choosing messaging inspiration from top brands. But these companies don’t need to stand out because they get massive tail winds from even more massive marketing budgets. They can afford to use lofty non-descript, inclusive messaging. You can’t. Get sharp, identify the market problems and how you fix them better than your competitors.

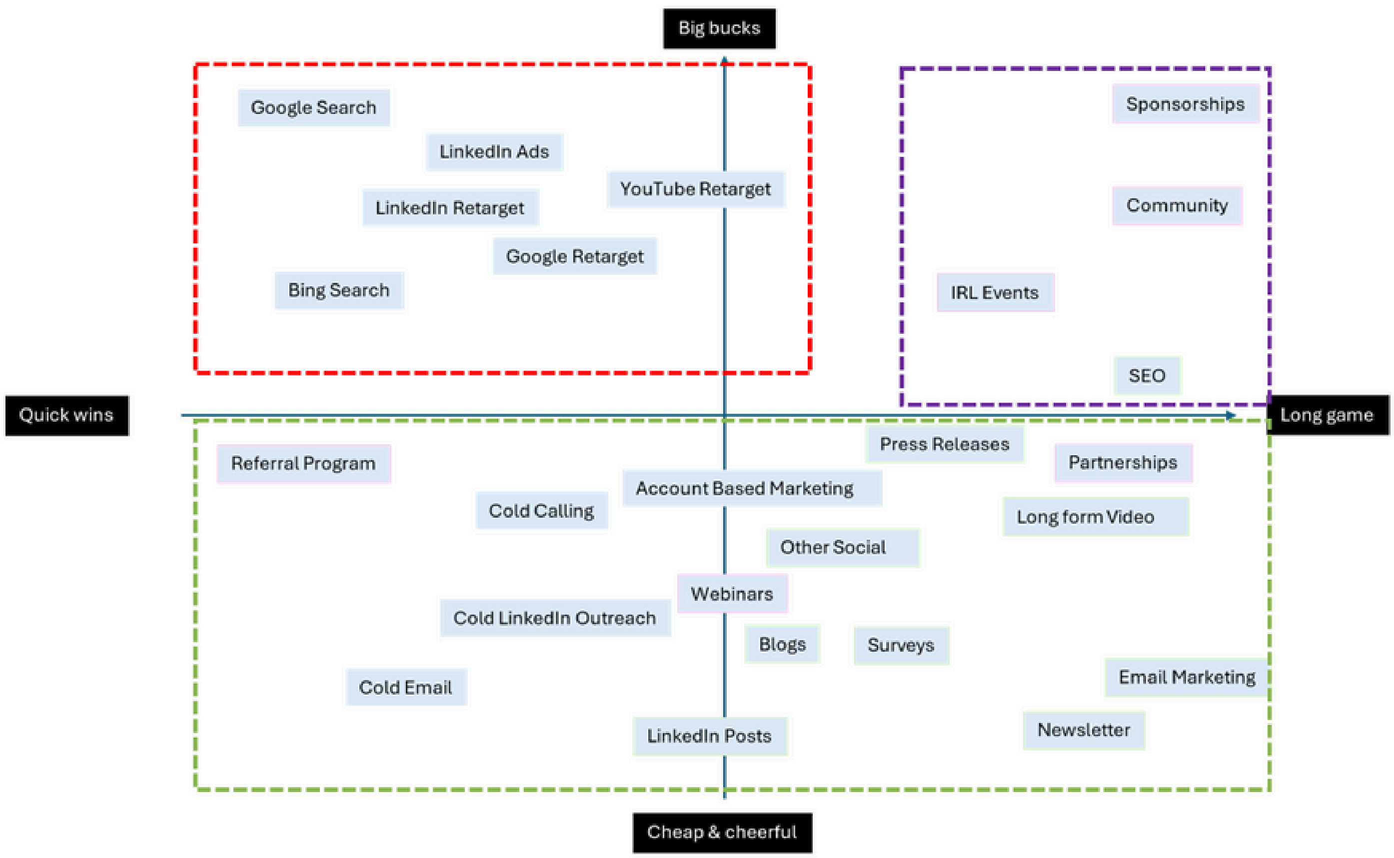
INCREASE THE SIZE OF YOUR FUNNEL

Create a dataset of your buyers
Inbound leads are great, but they are also very expensive and have a low conversion rate, so you'll need to depend on other methods to increase the size of your funnel.

Source a list of all your ideal customers. Load them into your CRM. Most likely, you will have multiple contacts to target in one account. Use an account centric approach to organize and track your data. There are great data sources and lots of tricks to getting data. Make sure your data source is high quality.

Engage with your buyers
Selling B2B requires you to engage with a buyer upwards 40 times before they take action. In fact a recent report from HockeyStack suggests it took a whopping 266 touchpoints to close a deal in 2024. And you'll need to do this across multiple channels: Email, calling, LinkedIn; as well as ads, community, referrals, video content, events, and other channels. It's estimated that less than 5% of your potential buyers are in an active buying cycle. So even if you hit them and they take notice, the timing may not be right, you'll need to reinforce your message over an over again until they are in market.

PICK TACTICS THAT ARE COST EFFICIENT



To achieve profitable growth the total sales and marketing cost should not exceed the total amount of ARR you collect in a year. If you are trying to close $1M in new ARR, don't spend more than $1M to get it. Does that sound like a ridiculous number? The biggest software companies you admire spend up to $20 to get $1 in ARR. This metric is called **Sales Efficiency** or the **Sales Magic Number**.

RETAIN & GROW YOUR CUSTOMERS

You're closing more deals and building a bigger funnel. Fantastic! Now its time to grow and retain your customers. This doesn't happen by accident; it requires programs and people.

Build an Onboarding Process

Buyer remorse can quickly set in with B2B technology projects - prevent this with clear communication and diligent project management. This onboarding process begins pre-sale, so set correct expectations with buyers and manage against them.

Provide Self-Service options

This could be in the form of a knowledge base portal, or even building a community of users. Give customers more options than just contacting your support team.

Get great at support

Create support terms and beat those commitments every time. Provide multiple support channels like email, portal, phone, or in-app. Track the tickets, build in email notifications at key times (e.g. ticket creation and resolution, and capture customer satisfaction results.

Segment your customers

You'll go broke if you try to provide the same level of proactive customer success to all your customers. Identify your customers in one of four segments and prioritize your engagement with the customers that want to engage with you.

Build automated Customer Success

Most customers won't require a high touch customer success strategy, it will be enough to provide automated customer success. Things like monthly webinars and newsletters can go a long way!

Build a Customer Success Model

For the 'strategic' customers, make sure you have a CS model that captures their business objectives and how you help them achieve those objectives. If they are not engaged with this process, demote them from a high touch model. Capture these objectives and track progress each quarter.

Track Customer Health

This does not need to be complicated. Temperature gauge of red, yellow, green works fine, even if just manually set. Net Promoter Score can be a simple way to capture sentiment.

360 Customer view

So often, your team will need to make five internal phone calls just to get a read on a customer. Do them a favor and get them that information on their fingertips.

PROTECT YOUR PROFITS

You've got your revenue game sorted, now there are some important processes that will ensure this turns revenue growth into profitability. This is another key element to Rule of 40.

Customer Profitability

Your best customers might not be who you think. You need to know both the annual and lifetime profitability of each customer. Include all revenue versus support cost plus delivery cost, customer acquisition cost / sales magic number to get a true measure of profitability. Be ruthless with the results.

Project Profitability and Resource Efficiency

Do you know:

- If your projects are profitable?
- Which are the most or least profitable and why?
- Who are your most efficient resources?
- How do efficient resources impact project profitability?
- Your least efficient resources?
- The projects where profitability is slipping?

To achieve the rule of 40, you need to carefully manage project profitability and resource efficiency. A few bad apples can ruin the bunch - find the source of the issue and correct it.

Manage your Subscription Revenue

Create a renewal process that ensures you calculate the renewed software values correctly. It's easy to miss add-on orders or contracted price increases.

Get on top of your invoices

Software orders, add-on orders, renewals, services invoicing. Its not uncommon to miss billing milestones, or a few billable hours per resource each month.

Integrated Accounting

Ideally, your entire billing and invoicing process can be managed without manual intervention so that you can get invoices out the door quickly but also close the month quickly. The longer it takes the harder it is to source root problems related to product lines, divisions, department costs, or direct sales costs.

LAGGING FINANCIAL METRICS

Annual and Monthly Recurring Revenue (ARR/MRR)

Track recognized ARR/MRR and ARR run rate (most recent month's MRR * 12). They are rarely the same value for growing companies. Track ARR growth rate as well.

Customer Lifetime Value (LTV)

This is the average revenue per customer x the average number of years a customer is retained.

Customer Acquisition Cost

Sum of Sales and Marketing Expenses in a given quarter over the number of new customers acquired in that same quarter.

Gross Margin

Total Revenue less Cost of Sales. The Cost of Sales gets a little hazy but the best practice is to include all third party software components, as well as services and support costs. Basically everything but OpEx.

Burn Rate

Total Revenue less Total Expenses.

CAC Payback

The number of months it takes to payback the sales and marketing costs to acquire that customer.

Gross Retention Rate (GRR)

The amount of recurring revenue in a given period less recurring revenue that churns (does not renew). For a mature company, this number should be north of 90%.

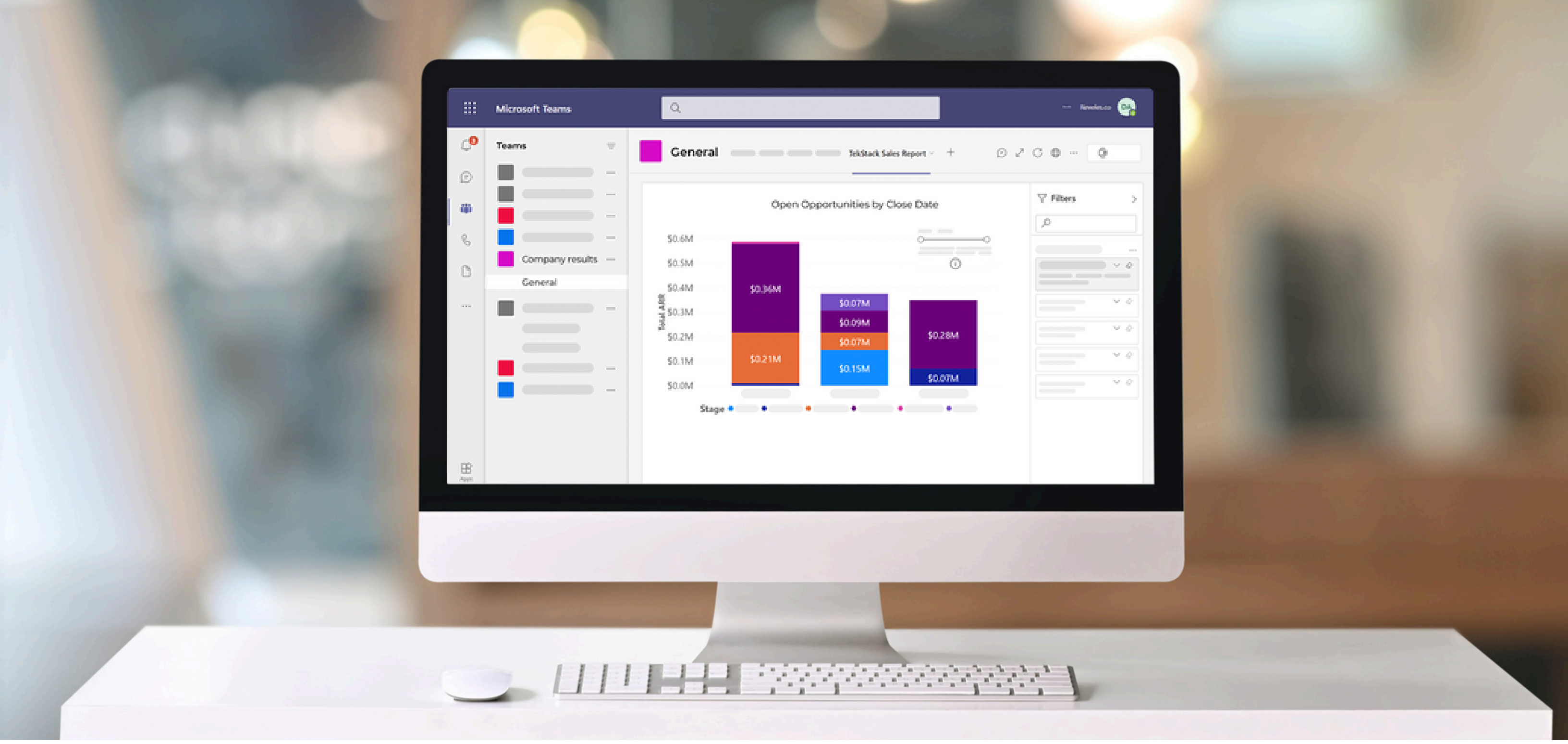
Net Retention Rate (NRR)

This is GRR but including any upsells or expansion revenue from customers in the same period. If you are between 100 and 110% you are doing great.

Sales Magic Number

The amount of new ARR that you can acquire for $1 of sales and marketing spend. If you spent $100K in a quarter and added $200K of ARR your sales magic number is 2.0. If your number is greater than 1.0 there is room to invest further in sales and marketing. If its less than 0.5 than there may be a need to improve a few things.

FIND YOUR SALES MAGIC NUMBER



LEADING SALES METRICS

Bookings
This is the dollar amount of sales that is booked. Booked sales is future revenue, rarely, unless it's hardware, can it be recorded right away. Booked sales may also have deferred cash collection. It's important to split booked sales out by revenue type. For example, recurring software value vs services; or tracking multiple years of booked sales versus one year, etc.

Opportunity Creation
The number of opportunities created in a period of time. (Ex. Monthly, Quarterly, Annually). Track opportunity types between New Customer, Existing Customer, and Renewal Opportunities.

Win rate
Number of Opportunities Won over Opportunities Won and Lost in the same period. Ideally track across New vs Existing, by industry, rep, region, product family, and opportunity source.

Average Contract Value
The average size of a new contract (bookings). Focus on new customer opportunities.

Sales Cycle Length
How many days does it take to close an opportunity from start to finish. Track New Customer from Existing Customer deals as they will be different.

Sales Velocity
A number which will tell you instantly if you have enough momentum to hit your number. It's the product of Number of Opportunities in Current Funnel x Average Contract Value x Win rate over Sales Cycle Length. The product will be the number of dollars you are closing each day. So if your target is $1M new bookings for the year, your sales velocity should be $2,700.

Funnel Attrition
This is the number of meetings it takes to get an opportunity.

OTHER OPERATIONAL METRICS

Services Backlog
Number of contracted hours you have approved. Divide that by your services capacity to tell you how many months of work you have contracted.

Utilization Rate
How many hours in a given period (week/month) is your services team busy on value creation (or billable customer work versus admin work). Your number should be north of 70% but best in class services teams would be in the 80% range.

Average Revenue per Employee
Total Revenue divided by Number of Employees. Ideally you will be operating at 2X the average cost per employee.

Project Gross Margin
Total Revenue less Cost as a percentage of revenue on a project. Ideally in the 40-50% range.

Customer Net Promotor Score
A simple but effective measure of customer satisfaction. The range is -100 to 100. A great score in B2B tech sectors would be 30+.

WHAT'S NEXT?

Companies that achieve profitable efficient growth as measured by the Rule of 40 are worth double the valuation multiple of their counterparts. The formula is simple, but getting there takes effort and rigor. It's a combination of people, processes, and systems. There are no silver bullets.

TekStack's R40 Performance program provides you the supporting role and is designed for bootstrapped founders who want to increase the value of their company by a factor of 3-5X within three years or less. Instead of hiring expensive new management, or implementing distracting new process and tools; work with TekStack to get faster results with less risk and less cost.

GET IN TOUCH

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