TUGBOAT INSTITUTE
GATHERING OF TEAMS

NASHVILLE
FEBRUARY 5-7 2025
TENNESSEE

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BE CURIOUS, NOT JUDGEMENTAL

CONFIDENTIAL

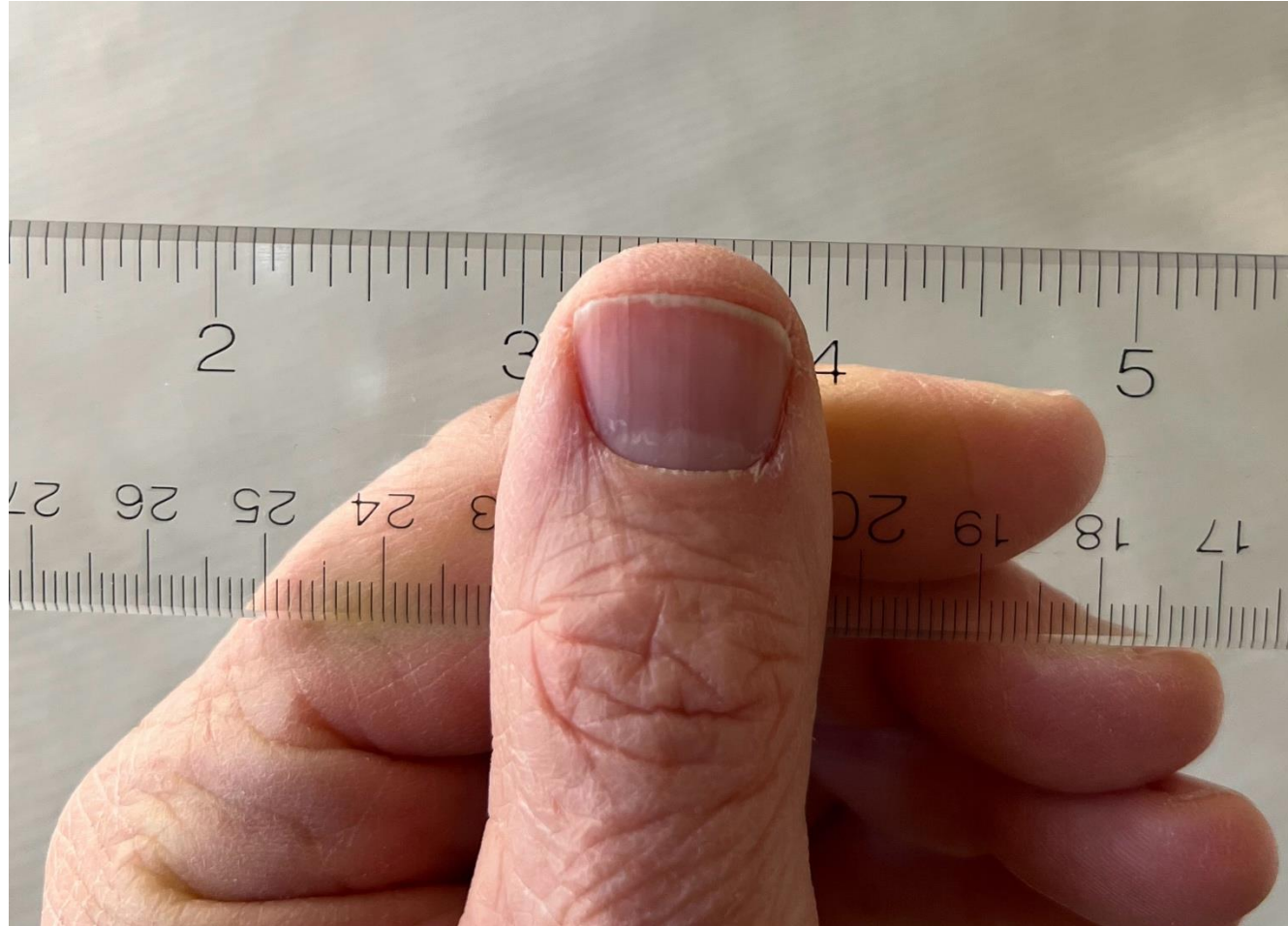# ON RULES OF THUMB

Tugboat Institute Gathering of Teams
February 5, 2025

Nashville, Tennesse
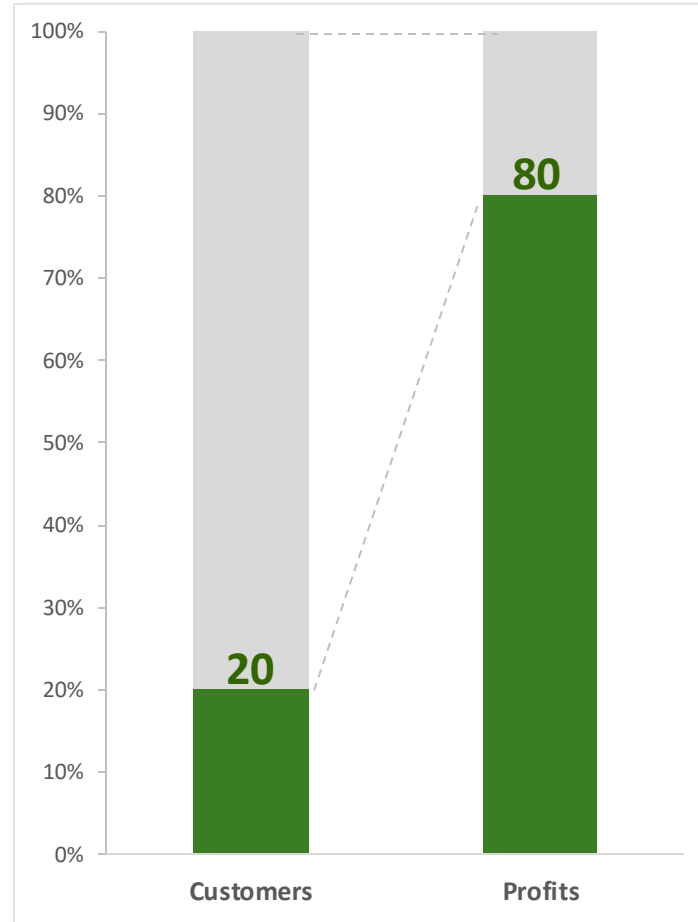
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IMPORTANCE OF RULES OF THUMB

Efficiency in Decision-Making

Simplifying Complexity

Capturing Experience-Based Wisdom

Effective in Uncertain Environments

Practical for Low-Risk Decisions

Rule of 40

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CHALLENGE: In their world of Get-Big-Fast, VC's lacked an easy way to guide software CEOs on **how to manage the trade-off between growth and losses**.

If done poorly, the company would be unable to raise funds and **run out of cash**

$$\text{Rule of 40 Score} = \frac{\textbf{Revenue Growth Rate}}{+} \quad > \textbf{40\%}$$
$$\textbf{Profit Margin*}$$

* Note: typically EBITDA

Crushing it: 100% revenue growth + (-50% EBITDA) = 50 $ $

Exciting: 52% revenue growth + (-10% EBITDA)   = 42 $

Living dead: 15% revenue growth + 12% EBITDA   = 27

Dead: 10% revenue growth + (-20% EBITDA)   = -10

Ignores measures crucial to **long term viability and success** such as:

Employee satisfaction and retention

Customer satisfaction, retention and lifetime value

R&D

What if below 40 for too long? Better get to 40+

Push sales

Cut expenses

…<u>not</u> the stuff of **strong foundations**

Rule of 72

RULE OF 72

OPPORTUNITY: Conveying the **scale, thus positive impact, arising from the long-term compounding of Paced Growth**

Rule of 72 estimates how long it takes for something to double

$$\text{Doubling Time (years)} = \frac{72}{\text{Annual Rate of Growth}}$$

Example: if growing at 10%, then 72/10 = 7.2 years to double

This formula simplifies the compound interest formula:

$$FV = PV \times (1 + r)^t$$

where *FV* is future value, *PV* is present value, *r* is the annual interest rate, and *t* is the time in years
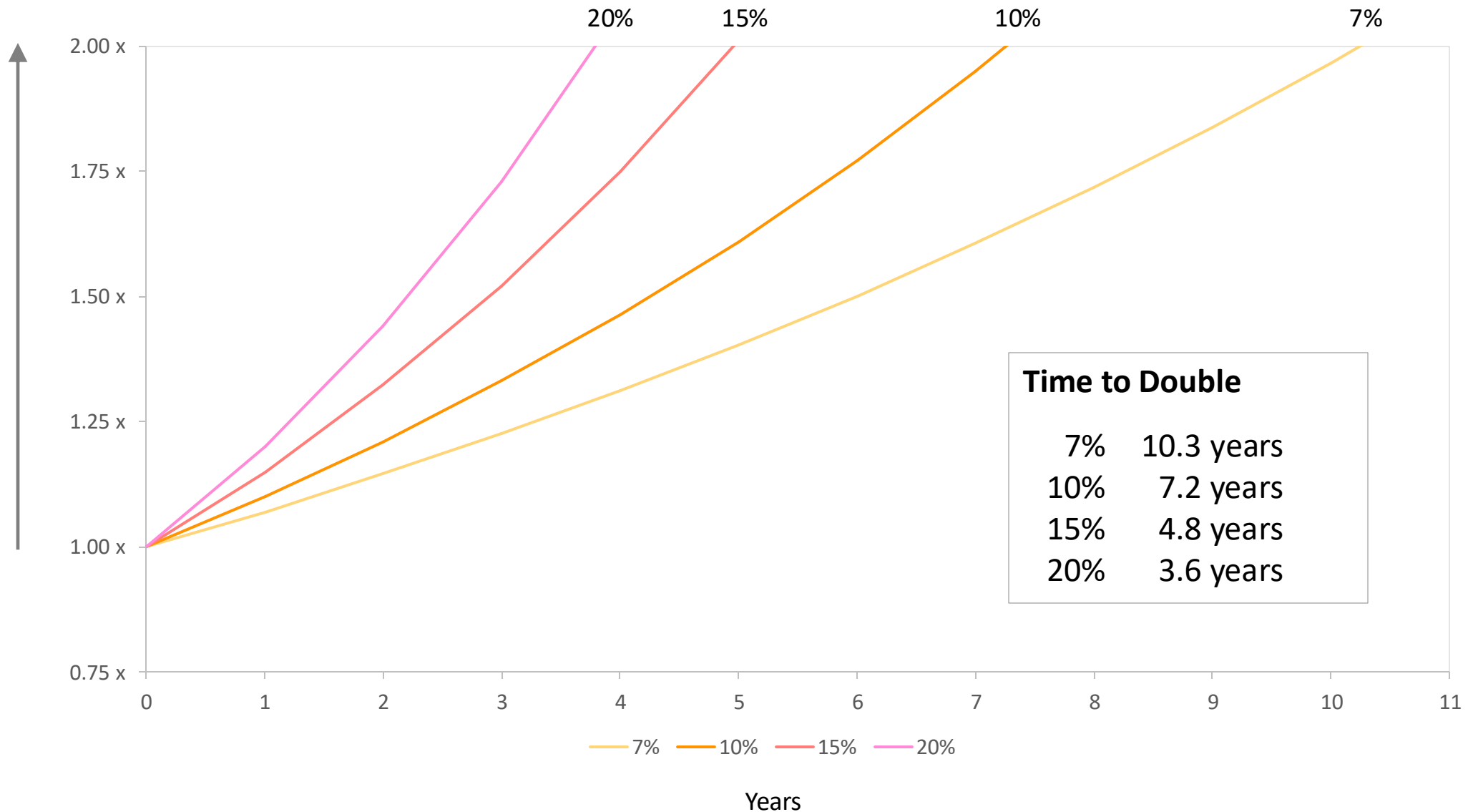
Solving for t:

$$2 = 1 \times (1 + r)^t$$
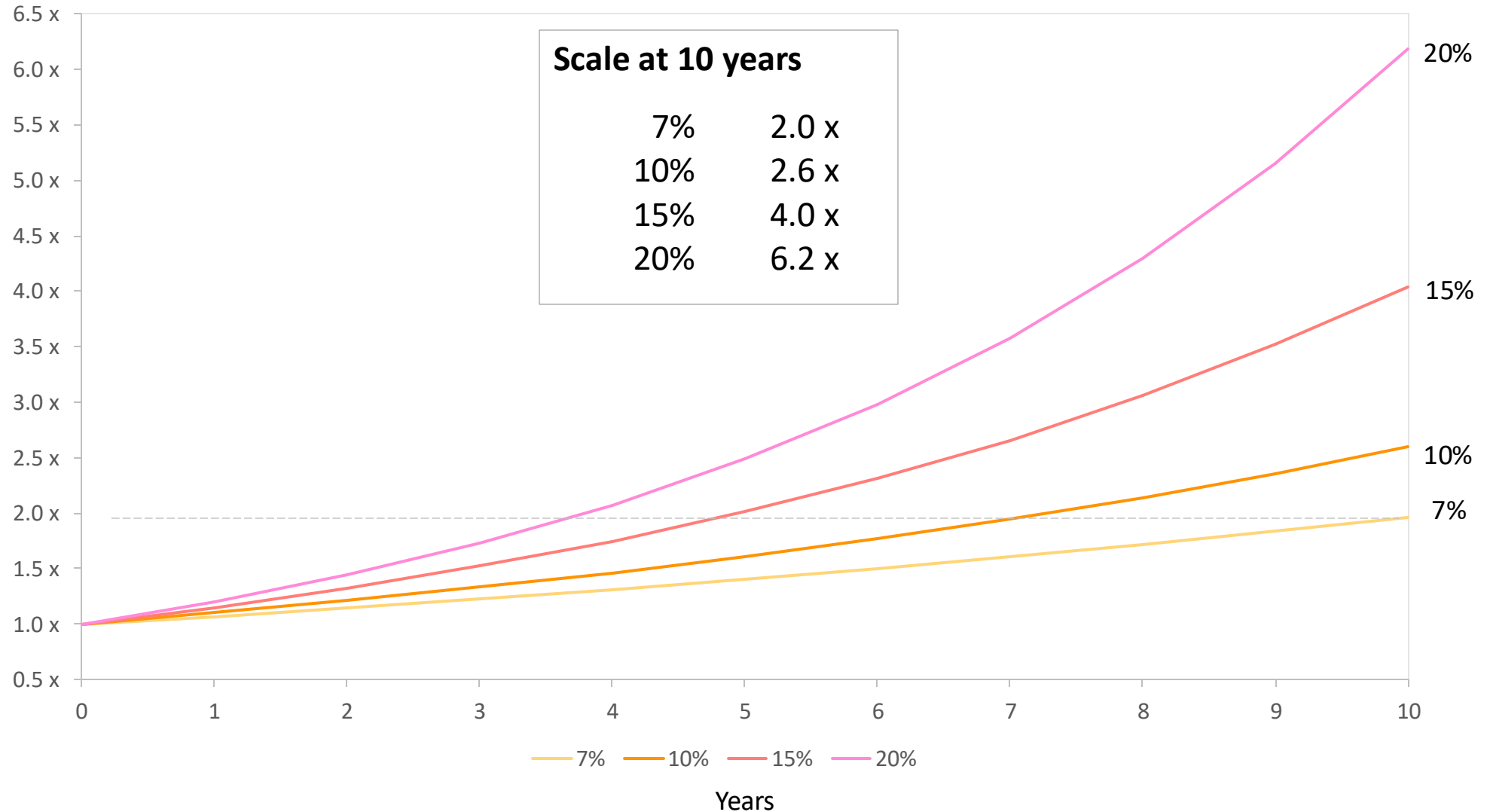
$$\ln(2) = \ln(1 + r) \times t$$

$$t = \frac{\ln(2)}{\ln(1 + r)} = \frac{0.69}{r} \times \frac{100}{100} = \frac{69}{r} \Rightarrow \frac{72^*}{r}$$

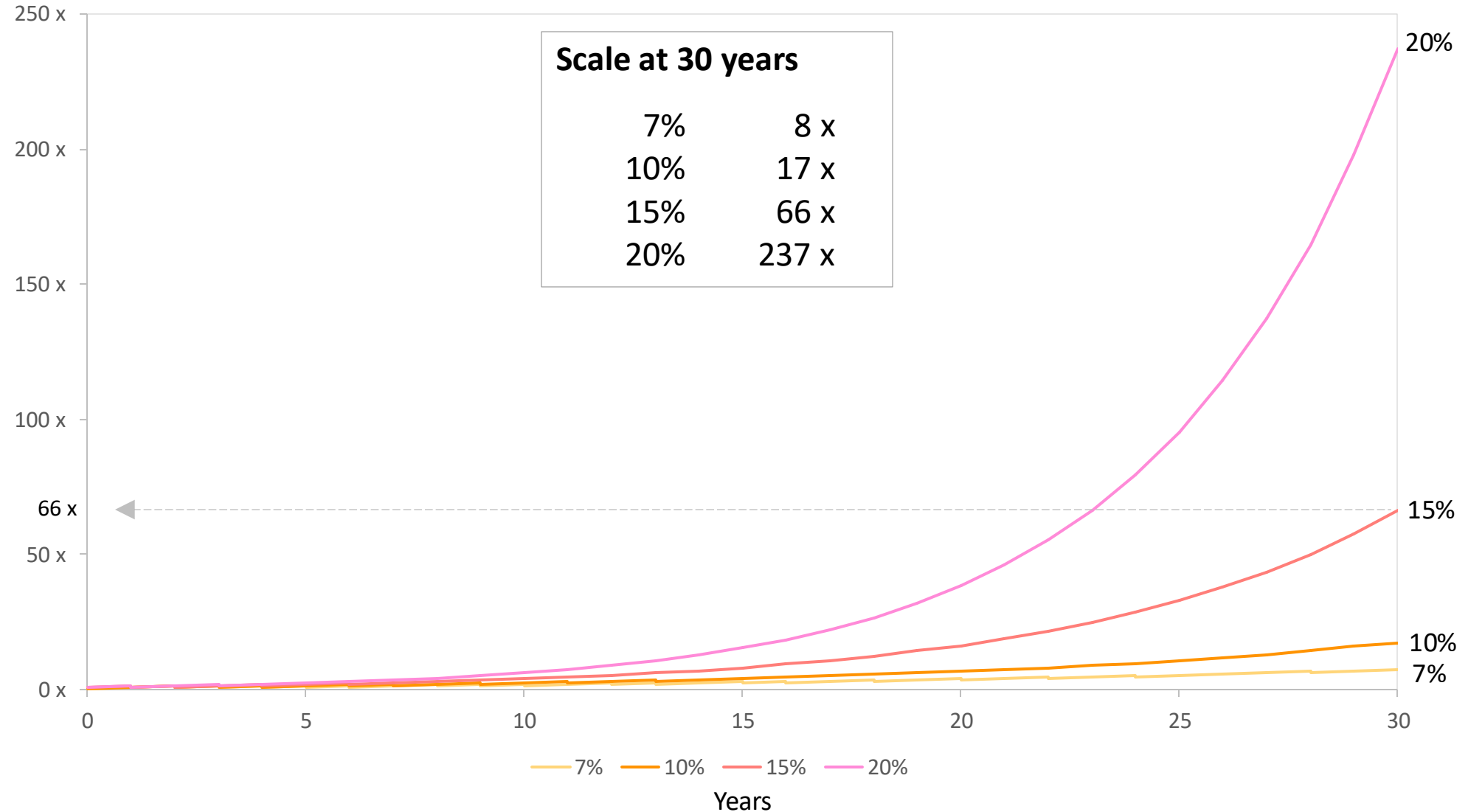*Note: Rounded to 72 because it is a highly divisible number

TIME TO DOUBLE AT 4 FIXED RATES

Time to Double

7%	10.3 years
10%	7.2 years
15%	4.8 years
20%	3.6 years

SCALE AT 10 YEARS AT 4 FIXED RATES

Scale at 10 years

7%	2.0 x
10%	2.6 x
15%	4.0 x
20%	6.2 x

Years

SCALE AT 30 YEARS AT 4 FIXED RATES

Scale at 30 years

7%	8 x
10%	17 x
15%	66 x
20%	237 x

20%

15%

10%

7%

Years

7% 10% 15% 20%

WHY NOT PUSH EVEN HIGHER?

It's hard to sustain and **real risk of outstripping** your

> Cash
>
> Management bandwidth
>
> Culture
>
> Time & Patience for Pragmatic Innovation

In real world, good to allow for slower periods to **absorb** higher ones

Ignore VC's Rule of 40 and "Living Dead" nonsense

Embrace the **Rule of 72** and **Paced Growth**

+ **Get a little better**, day-after-day, week-after-week, month-after- month, year-after-year, decade-after-decade…**Kaizen**

+ Have the **patience and courage** to thrown in some **invention**

+ Further **mature and improve** on the other **Evergreen 7Ps**

You and your team will find yourselves running a **significant Evergreen company, positively impacting more and more lives, that lasts…and lasts…and lasts**!

"Greatest calling of a company is to be an Ethical company" / "a purpose-driven company"