**Stanford eCorner**

**The Importance of Unit Economics**

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Kathleen Eisenhardt, Stanford W. Ascherman M.D. Professor in Stanford Engineering, encourages new founders to prioritize being profitable at the unit level. Paying attention to unit economics, she says, helps build simpler business models that are easier to replicate and scale, and leads founders to a better strategic understanding.

## Transcript

- Final thing I'll talk about in terms 00:00:05,640 of economics is unit economics, which is something we tend to forget about, particularly when you're talking about physical good, but really any good that's got at least some variable costs, even software has some variable costs around customer acquisition or around, for example, customer support.. The importance of unit economics, because if you can't make money on a basic transaction, like when I sell the pen, I can't make money.. All you do when you grow is you lose more and more money.. And so this is, again, this is the unit level, so you may choose to be unprofitable at the firm level, but it's really important to be profitable at the unit level and take that as a first priority that you do, particularly if there are any kind of variable costs.. And there are a couple reasons why that's true.. One of the things is if you focus on variable, if you focus on unit economics, that means the revenue minus the costs is the profit.. You, of course, are gonna have more profitable unit economics, that's sort of obvious, but what you also do is you tend to also build a simpler business model, and a simpler business model is easier to replicate and easier to scale.. The other thing that you get when you focus on unit economics, it forces you to look at more aspects of the business.. For example, we were looking at online fashion, and one of the companies we looked at was carrying inventory and sending clothing out to people, out to consumers.. They started looking at shipping, and then realized that they actually changed their business model to if you buy five product, if you buy five outfits, you get a cheaper price, saved on the shipping costs..

They realized that they charged people 20 bucks to use the site, they got better customers.. So even though they lost some customers, they got customers who are more likely to buy.. So as you explore the costs and the revenue and the interrelationship of cost and revenues, you start to develop a better strategic understanding.. So unit economics not only forces you to be more, oh, not forces you, but encourages you or leads you to better unit economics.. It leads you to simpler unit economics, which scale better and leads you to a better strategic understanding of your business.. By contrast, the entrepreneurs who simply focus on growth, they find product market fit and start growing.. They never really understand the business well enough, and in the meantime they start developing a culture of we're growing, it's great to grow, and they keep, but what they can never, what's very hard to go back to doing as you're scaling is to go back and fix the unit economics and after a while, your funders get tired.. What they don't see that you're ever gonna be profitable.. If you're in a big market like Uber, they'll wait a long time.. But for most startups, they wanna see some profitability..

So they'll encourage, VCs will encourage you for growth early on, but then they'll turn the tables on you around series C and say, "so when are you gonna be profitable?"..