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1/19: This may sound funny but I actually have a favorite business model.

We all know that the goal of business is to sell a good/service at a higher price than it costs to manufacture and distribute.

My favorite business model is designed to do this extremely well. 🙌🤪



2/19: The easiest way to go broke as a business is to sell dollar bills for less than a dollar. To survive, a business has to sell “widgets” at a price that generates positive contribution margin (PCM). The more PCM generated per “widget” the easier it is to overcome overhead.

3/19: Many business models rely on sourcing goods at wholesale costs and then distributing them through their own channels at a retail price. Buying in bulk at a discount and selling smaller parcels at a premium is how PCM is generated.

4/19: In these models, much of the PCM is typically eaten up by distribution costs and the costs of capital “trapped” in inventory that’s stocked but not yet sold. And when competition for the end-customer enters the mix, margins can be put under immense pressure.

5/19: In contrast, there's a different type of model that relies on “alchemy” to generate PCM. This can add an additional layer of margin to the system which can be substantial.

At this point you’re probably wondering: “What the heck does he mean by alchemy?”
Read on.

6/19: Alchemy as a Business Model

Alchemy is “a seemingly magical process of transformation, creation, or combination.” Alchemy takes a thing of lesser value and with specialized tools and fine-tuned expertise transmutes it into something of greater value.

7/19: Sourcing something of lesser value and transmuting it into something of greater value can generate loads of contribution margin if the cost of the transformation is only a fraction of the value being created. The “return on the alchemic process” is what matters.

8/19: One great example of this is the “upcycling” of real estate. Purchasing houses with severe deferred maintenance issues and transforming them into renovated and upgraded “as-new” houses is one form of “upcycling” (fix-and-flip).

9/19: If managed correctly, the economics of a fix-and-flip can be very attractive. It’s not unusual to see a property with major issues sell for half of its “as repaired” value. If a flipper can do the repair work for a quarter of the sale price they can make great money.

10/19: Add financing to the mix and the math improves even more. A \$500K house that needs \$200K in repairs could be financed with the borrower responsible for 25% of the total amount. \$175K in equity is tied up = Leverage at work!

11/19: If the rate on the loan is 10%, the repairs are managed efficiently (4 months) and the house is sold quickly (1 month) for a premium (\$1MM), the return is amazing even after transaction costs (6%).

\$218K of profit on \$175K of equity tied up for 5 months!

12/19: The alchemic process is amazing if managed well. But finding and winning the properties in a competitive market isn't always easy. Being disciplined around what value various repairs will generate matters. Managing your crew and not wasting materials is critical.

13/19: In case you're wondering, a few businesses that are doing great work in-and-around the "find and upcycle real-estate" space are: [@SundaeHQ](#) (US) and [@loft_br](#) (Brazil). Their models, target homes and geographic footprints are different but both are on fire.

14/19: Another example of "alchemy at work" can be seen in the innovate models that are growing quickly and dominating the used car market.

Some great "alchemic" businesses have emerged in the space. [@CarMax](#), [@Carvana](#) and [@kavakmx](#) are a few.

15/19: Take Kavak as an example. They buy and sell used cars in a very modern way. You can search their inventory on-line (or in-store) and they'll deliver any car you're interested in directly to your house. They arrange financing and give you a risk-free trial. Buyers love it!

16/19: But a big piece of their value proposition is an alchemic process that results in increased trust in the car being purchased. The cars they sell are worth more than the cars they're buying because of the work they do after intake.

17/19: Kavak certifies their cars through a 240-point inspection. Kavak reconditions their cars and will routinely invest in items like tires and brakes to make sure their cars are in fantastic shape. And Kavak guarantees their work with a 3-month warranty that can be extended.

18/19: The model is fantastic and their alchemic process is the foundation for a very durable business. They don't have to rely on arbitrage to lock in margin. They can pay great prices for their cars because the work they put into the cars generates alpha. Alchemy at work!

19/19: The TL;DR: All healthy businesses need to find a way to systemically generate positive contribution margin. My favorite business model relies on alchemy to generate alpha. Once you see alchemy at work you can't unsee it and you'll start to look for it everywhere!

And I'm catching a lot of flack for the stone age graphic I used in the first tweet. I'll own it and promise to do better in the future! Thanks [@hoomanradfar](#) for being the first of many to call me out....sigh!

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