The Rule
of 40

A quick health check for fast-growing companies, especially SaaS. It says one simple thing: your revenue growth rate plus your profit margin should add up to at least 40%. It lets anyone judge, in seconds, whether a company is balancing growth with profitability.

Best for: SaaS · Subscription software · High-growth startups · Investor screening

01 — AT A GLANCE

The whole rule is a single equation: add two numbers and see whether they clear the line.

Revenue Growth % How fast sales are rising (year on year)	+	**Profit Margin %** Share of revenue that becomes profit	≥	**40%** The healthy threshold

02 — THE CORE COMPONENTS

Just three things to understand — two inputs and the threshold that ties them together.

Revenue Growth Rate `(This yr − last yr) ÷ last yr × 100`	The year-over-year rise in recurring revenue (ARR or MRR is preferred because it's predictable). High growth signals the company is winning its market.
Profit Margin `Profit ÷ revenue × 100`	How efficiently revenue turns into profit — EBITDA margin is the usual choice. It shows the business can stand on its own without burning cash forever.
The 40% Threshold `Growth % + Margin % ≥ 40%`	The balance point. Clear it through fast growth, strong profit, or a healthy mix. Below 40% suggests the company is either growing too slowly or spending too freely.

Growth and profit can trade places

A young company might score 35% growth + 5% margin = 40%. A mature one might score 5% growth + 35% margin = 40%. Both pass. The rule rewards balance, not any single number — which is exactly why investors love it.

03 — WHEN TO USE IT & WHEN NOT TO

This framework isn't right for every situation. Used at the wrong moment, it can point you in the wrong direction.

✓ USE IT WHEN…	✗ DON'T USE WHEN…
• Judging a SaaS or subscription business at a glance	• Very early, pre-revenue startups with no stable numbers

✓ USE IT WHEN…	✗ DON'T USE WHEN…
• Comparing companies at different growth stages • Investor screening and board reviews • Deciding whether to push growth or tighten margins	• Non-software businesses with different cost structures • As your only test — it can hide extremes • When growth is a one-off spike, not recurring

04 — IN ACTION

TaskNest — A Project-Management SaaS

TaskNest sells a team task-management tool on monthly subscriptions. Revenue is growing nicely, but the founder keeps burning cash — and an investor just asked, 'Are you actually healthy?' The Rule of 40 settles it in one line.

How the framework was applied:

Step 1	**Measure growth —** ARR grew from ₹8 cr to ₹11 cr last year. Growth rate = (11 − 8) ÷ 8 = 37.5%.
Step 2	**Measure margin —** EBITDA was −₹1.1 cr on ₹11 cr of revenue. Profit margin = −10%.
Step 3	**Add them up —** 37.5% + (−10%) = 27.5%. Below 40 — TaskNest is growing fast but losing too much to be healthy.
Step 4	**Choose the lever —** Growth is already strong, so the fix is margin, not more spending. Trim discounting and cut two underused tools.
Step 5	**Re-check —** A year later: growth 32%, margin +9% → 41%. TaskNest now clears the bar without slowing down.

The numbers at a glance

Growth	Margin	Score	Target
37.5%	**−10%**	**27.5%**	**≥ 40%**
ARR ₹8cr → ₹11cr	EBITDA on revenue	Below the line	Healthy zone

What the single number revealed

Revenue growth alone made TaskNest look like a winner. The Rule of 40 exposed that the growth was being bought with unsustainable losses. The fix wasn't to grow harder — it was to grow profitably. One quick sum pointed straight at the real problem.

05 — KEEP IN MIND

Even experienced teams slip up here. Keep these in mind to keep your analysis honest and useful.

1. Treat it as a screening tool, not a verdict — always dig deeper before investing.
2. Use recurring revenue (ARR/MRR) for growth, not one-time spikes.
3. Be consistent about which profit margin you use — EBITDA is the norm.

4. Watch the extremes — a wild number on either side can game the rule (100% growth, −60% margin still 'passes').
5. It fits software best; apply it cautiously outside SaaS.