

How Do You Make Money Off Your Product?

Lecture 10 - Part 2
GSL Peru 2014

Housekeeping

- Please turn in your High Level Product Specification
- Do not forget to interview 5 people that meet your persona
- Friday's are not optional

Housekeeping

- Video Crews in this Wednesday (afternoon) and Thursday, 23th and 24th
- Guest speaker from Wyra on Wednesday or Thursday
- No Labs Thursday afternoon

- No classes on holiday next Monday 28th and Tuesday 29th

Housekeeping

- Demo Day
 - computing resources?
 - other resources?

Roadmap

Review

- Persona, Value Creation, Strategy
- Software Design

This Week

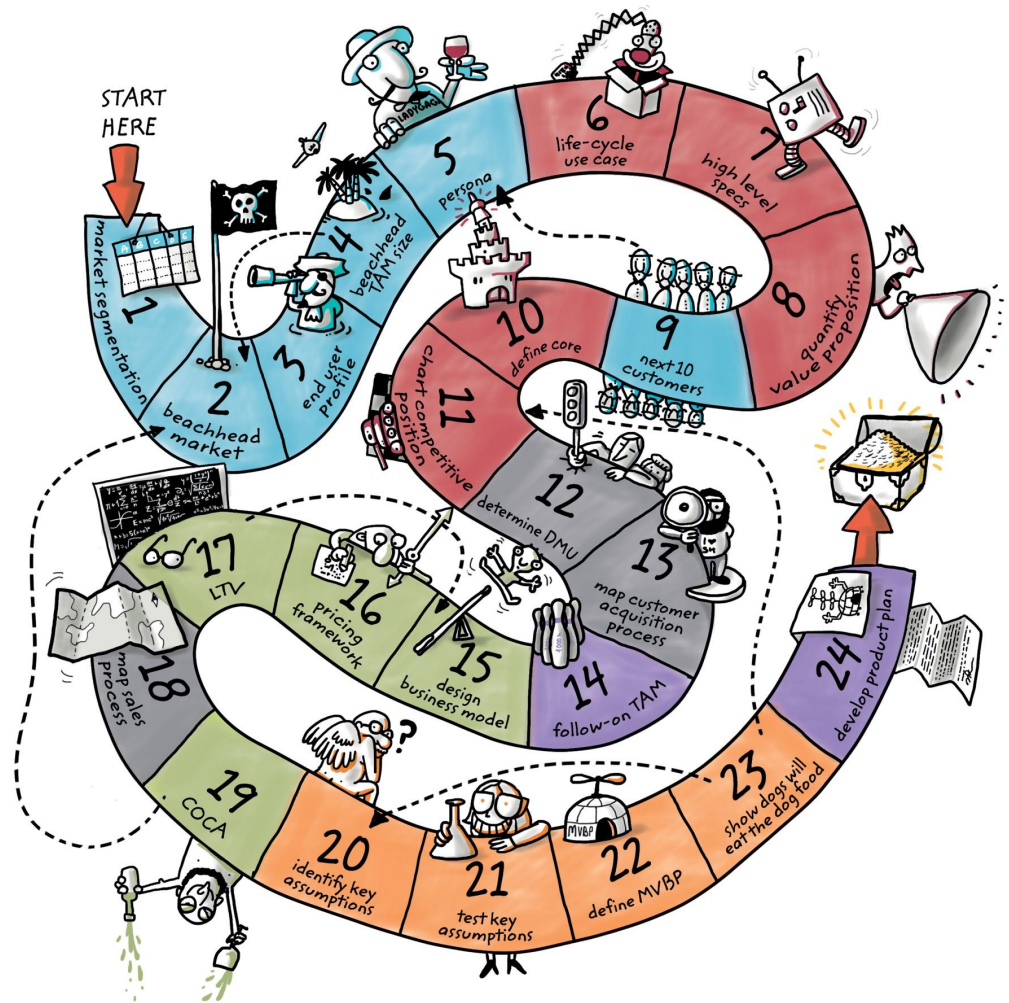
- Finish Super High Level Business Plan
- High Level Prototype Plan

Moving Forwards

- Executive Summary
- Prototype

HOW DO YOU MAKE MONEY OFF YOUR PRODUCT?

- 15 Design a business model
- 16 Set your pricing framework
- 17 Calculate the lifetime value of an acquired customer (LTV)
- 19 Calculate the cost of customer acquisition (COCA)



Map Sales Process

Dude,
you really want
to know each step!

That is the only way
we will solve the riddle
of the COCA in this case.



Map Sales Process

What?

- Visually map the short, medium and long term way you will create and fulfill demand for your product.

Why?

- This will be critical input to calculating the Cost of Customer Acquisition (COCA) over time.

Map Sales Process

More...

- Map out your Sales Process including channels. It is very important to understand your short, medium and long term sales strategy and vet this with experienced professionals in the industry. This is often overlooked and will have a huge impact on Cost of Customer Acquisition calculation in the next step.

Map of Sales Process

Short Term

- Direct Sales (100%)  All end customers w/ focus on strategic accounts in target market


This would continue until Word of Mouth becomes significant and product is matured and proven. Then as move from demand creation to demand fulfillment ...

Medium Term

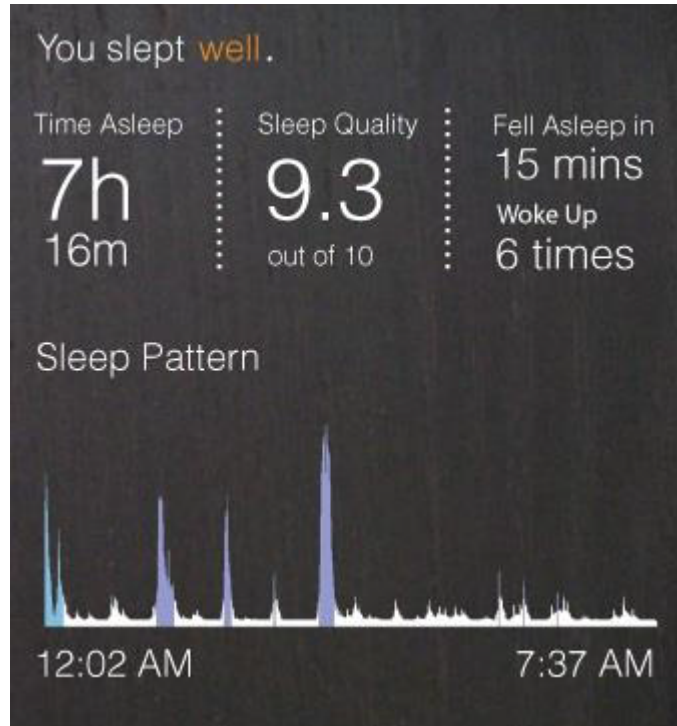
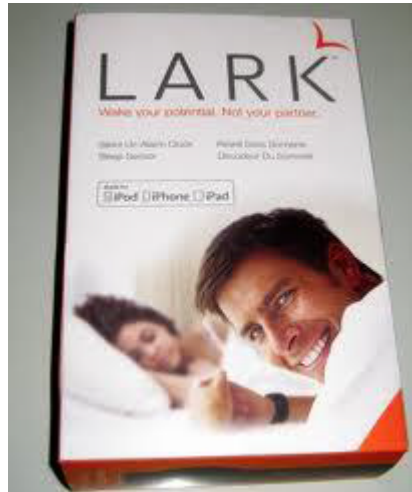
- Direct Sales (50%)  Largest customers
- Selected Regional Exclusive VARS (50%)  Medium and small accounts in target market

This would eventually evolve to more of an online commerce as the product becomes the standard and the product line expands & new markets are tested – estimated in year 3

Long Term

- Direct Sales (25%)  Top 50 accounts & new market
- Selected Regional Exclusive VARS (40%)  Accounts below Top 50 & non-core markets
- Thru Web Site & Direct Telemarketing (35%)  All customers in core market (with commission to VARS & Direct Sales)

Lark



Lark

- Short
 - Educate customers 1-1. Too new of a concept.
 - Public speaking engagements.
 - Word of Mouth through family and friends
- Medium
 - Deal with Apple Store
- Long
 - 40% website
 - 50% retail
 - 10% other channels

Calculating COCA

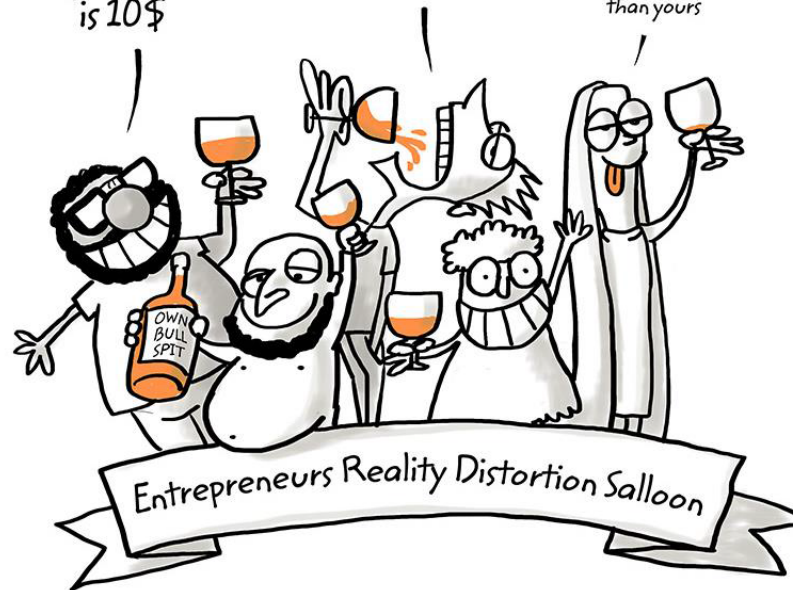
This always happens.
I will get them out of here
and back to reality tomorrow
when they sober up



My COCA
is 10\$

Mine is 5\$!!!

My COCA
is more awesome
than yours



COCA

What?

- Estimate the total marketing & sales expense in a given period to get new customers & then divide this by the number of new customers.

Why?

- The unit economics are a simple but effective proxy for how sustainable & attractive your business will be as it scales.

COCA

More...

- Very importantly now, you will do your first COCA calculation to determine all the sales and marketing costs it takes to get a new customer. This does not include fixed costs or costs of goods sold. It is simply all the sales and marketing costs (including those customers who you unsuccessfully try to sell to) to gain a new customer. Don't worry if you have it completely correct on the first pass – you will refine it over time – but make your best guess and understand what you believe are the key drivers. Also note how it will evolve over time, hopefully coming down, and what are the drivers of this important expense reduction.

Deeper Dive on COCA

- What exactly is COCA
- How to calculate it
- Key Factors
- Action items

More Precisely...

Example: Our new venture will sell a widget and to successfully acquire a new customer it takes one of our sales people $1/20$ of their time for 6 months.



More Precisely...

- Let's assume we pay the sales person \$150K per year if they make 100% of their assigned quota. We will assume they make their quota.
- Then the sales person's expense to close this deal might be seen as:
- $\$150K * (6 \text{ months}/12 \text{ months}) * (1/20) = \$3,750$
- But there is more ...

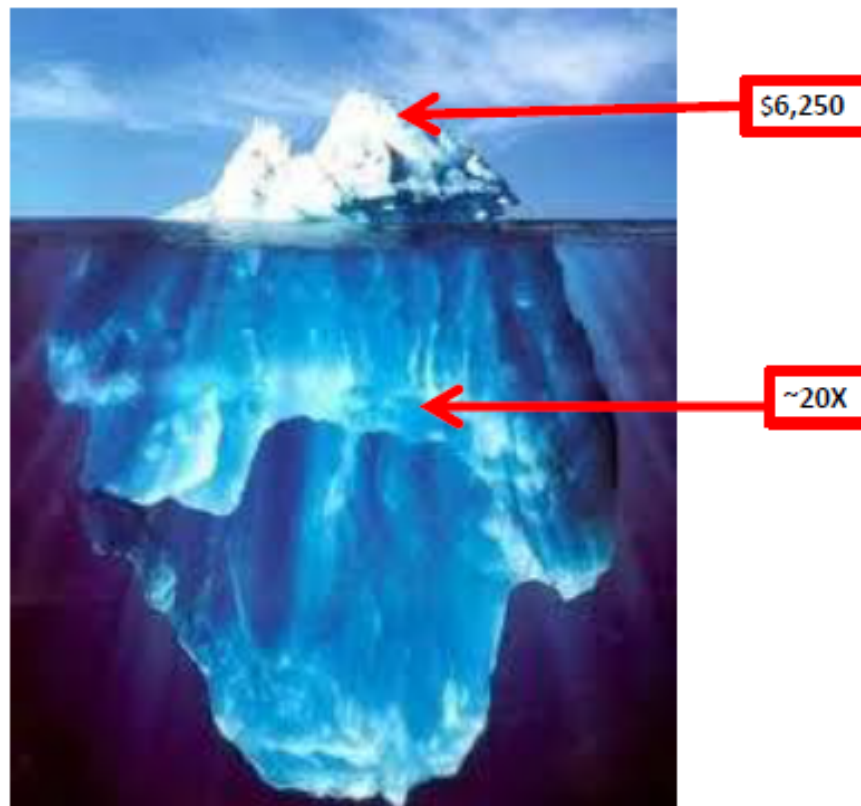
Additional Cost

- The sales rep has to be assigned their full costs beyond salary
- This could include: auto, real estate, administration, benefits, administration allocation, phone, internet, computer, etc.
- After we do a lot of digging and calculating, we estimate this to be \$1,000.

Additional Cost

- Then incidental costs associated with this account of travel, lodging, entertainment, demo units, tech support, etc. need to be included.
- After doing a lot of receipt checking and the like we estimate this to be \$1,500
- Then **COCA=\$3,500+\$1,000+\$1,500**
=\$6,250, right?

Wrong!



Why?

- Initial calculation did not include the conversion rate of 5% for the sales rep
- So the rep has to track 20 prospects for every sale and incurs the costs of these non-performers as well
- The sales cycle of 6 months is probably well below average

Why?

- There were many other resources that went into making the sales rep successful – e.g., website, sales support, advertising, tradeshow, help of executives, etc.
- Logically the bottoms up methodology should work if you took a long time and got to understand all of the costs but that is very difficult and costs are generally missed or even double counted
- The good news is that there is a much easier way that is more accurate ...

Calculating COCA Correctly

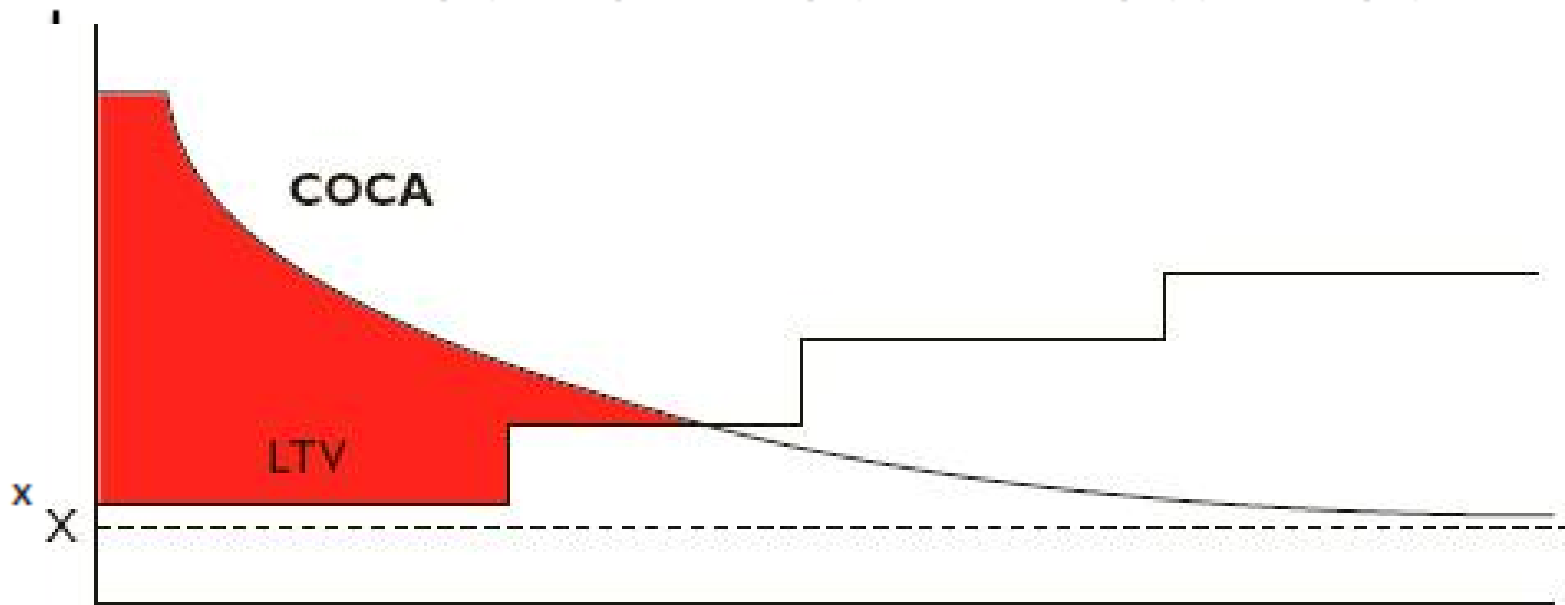
- Determine all your marketing and sales cost for your company for a set time period.
- That time period is related to the length of your sales cycle.
- It should be at least 2 times your sales cycle.
- Include not just the expenses for your marketing and sales group but also, if it is significant, an allocation of the executives and/or any other resources involved in sales & marketing.
- We will call this number $TMSE(t)$ for Total Marketing and Sales Expense for a time period t .

Calculating COCA Correctly

- Next, you determine if there is a substantial amount of the $TMSE(t)$ that is dedicated for customer retention, e.g., customer support on going customers and we will call this $IBSE(t)$ for Install Base Support Expense for time period t .
- We will then determine the number of new customers we close in the same time period and we will call this $NC(t)$ for New Customer in the time period t .

Calculating COCA Correctly

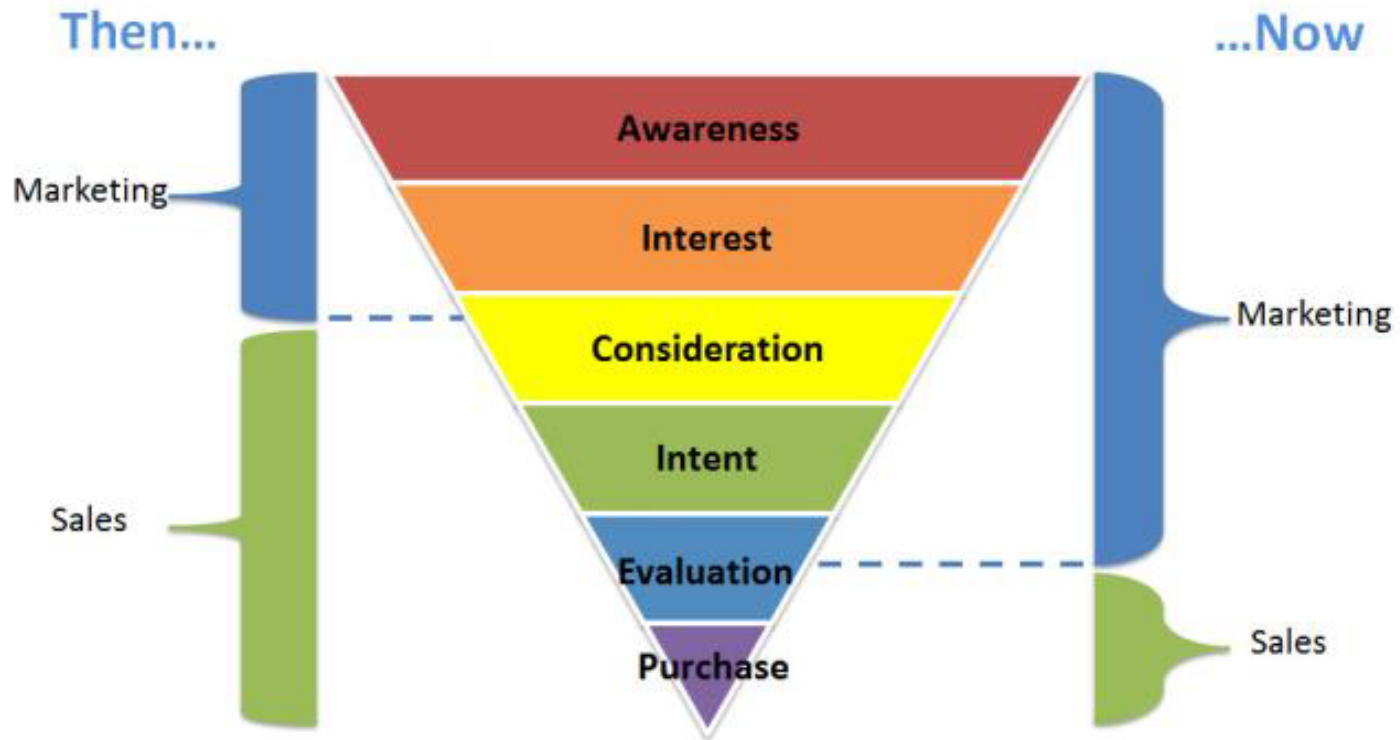
$$COCA(t) = (TMSE(t) - IBSE(t)) / NC(t)$$



Key Factors for Reducing COCA

- Direct Sales vs. Telesales
- High Touch vs. Automated
- Conversion Rate
- Cost of Leads
- Quality of Leads
- Word of Mouth (WOM)
- Moving them Down through the Sales Funnel
- Design of Your Business Model
- Focus => Decrease Sales Cycle

The New Marketing & Sales Funnel



Now

- You should have know who your customer is with great clarity
- You should have high confidence in what your value proposition is and your competitive advantage in providing this
- You should have good confidence that you can make sufficient money selling the product
- We have an increasingly specific product definition
- Now it is time to think about making the investment to make it ...

References

New Enterprises Lecture Notes - Bill Aulet

Disciplined Entrepreneur - Bill Aulet