



# How Do You Make Money Off Your Product? I.e., How Do You Capture Value? (Steps #15, 16, 17 & 19)

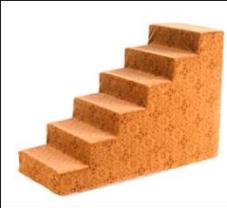
Class Thirteen

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# But before we talk about that...

- Comments on sections that you are getting back now (Target Customer & Value Prop, Market Definition, and Competition)
- Reasonable job on picking BHM but still could be better
- **Target Customer & Value Prop** sections are the most concerning to me
- This is the foundation for all that follows
- Blending of the Target Customer Profile & Persona into one – follow the structure of the steps
- Target Customer Profile is just the start – a range – helps to determine TAM
- Persona is an actual person who is very representative of the target customer segment – specificity is more valuable
- On the persona, one of the most important items is the “purchasing criteria”
- Don’t make this stuff up! Do primary market research to find out
- It can change – you can spiral to an optimal persona



# Market Definition Section Feedback

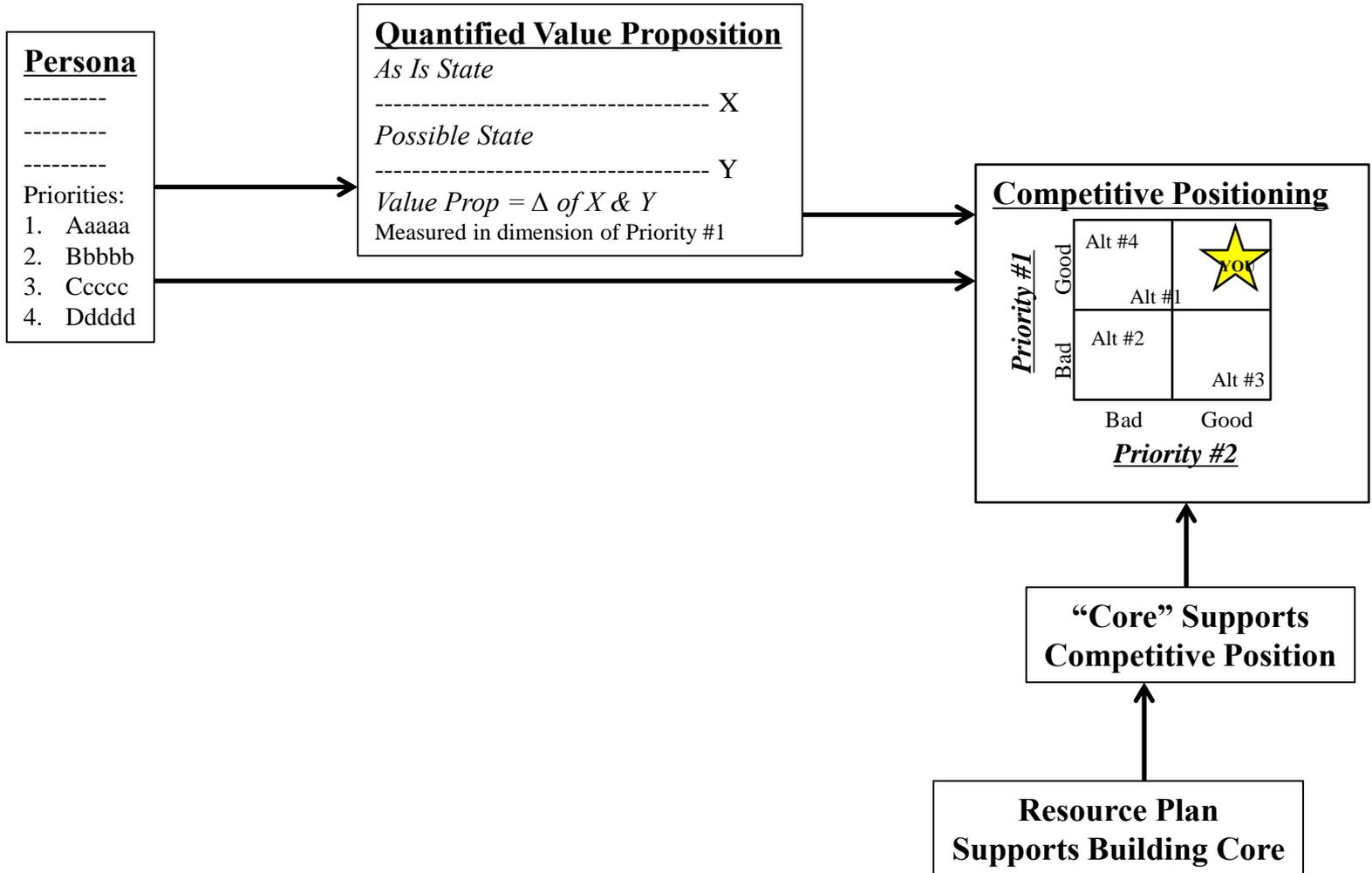
- All in all, people are much more comfortable with secondary research & analysis ... and it is valuable
- But needs to be in the flow & linked to primary market research work → Keeps it from becoming an abstract consultants report
- In the end you want to know:
  - ▶ TAM for BHM (\$ per year)
  - ▶ CAGR (Compound Annual Growth Rate) for BHM TAM
  - ▶ Trends & Characteristics
  - ▶ Key players
- This is not an academic exercise but rather a plan for action



# Competition Section

- Do not do a feature comparison
- A more holistic analysis
- But do have linkage to the rest of your plan ...

# Competition Section Linkages

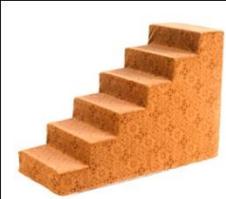




# IMPORTANT!!!

## Next Section & All Sections Going Forward You Will Need A ...

- **Tagline**
- Put it right under your company name on the front page
- It is expected to spiral & get better over the course of the semester
- 4 key elements to a good tagline things:
  1. Is addressed to your target customer
  2. Clearly states your value proposition
  3. Sets the rules so you win (i.e., the question of “why you?” is clear or becomes clear if they buy into your tagline)
  4. It is memorable

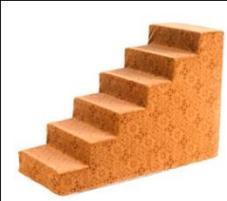


# Reviewed to Date

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Who is Your Customer?	What Can You Do for Your Customer?	How Does Your Customer Acquire Your Product?
<p>1) Market Segmentation</p> <p>2) Select a Beachhead Market</p> <p>3) Build an End User Profile</p> <p>4) Calculate the Total Addressable Market Size (TAM) for the Beachhead Market</p> <p>5) Profile the Persona for the Beachhead Market</p> <p>9) Identify Your Next Ten Customers</p>	<p>6) Full Life Cycle Use Case</p> <p>7) High-Level Product Specification</p> <p>8) Quantify the Value Proposition</p> <p>10) Define Your Core</p> <p>11) Chart Your Competitive Position</p>	<p>12) Determine the Customer's Decision-Making Unit (DMU)</p> <p>13) Map the Process to Acquire a Paying Customer</p> <p>18) Map the Sales Process to Acquire a Customer</p>

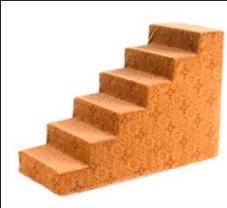




# To Be Discussed Today

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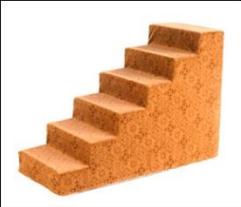
Who is Your Customer?	What Can You Do for Your Customer?	How Does Your Customer Acquire Your Product?	How Do You Make Money off Your Product?
<p>1) Market Segmentation</p> <p>2) Select a Beachhead Market</p> <p>3) Build an End User Profile</p> <p>4) Calculate the Total Addressable Market Size (TAM) for the Beachhead Market</p> <p>5) Profile the Persona for the Beachhead Market</p> <p>9) Identify Your Next Ten Customers</p>	<p>6) Full Life Cycle Use Case</p> <p>7) High-Level Product Specification</p> <p>8) Quantify the Value Proposition</p> <p>10) Define Your Core</p> <p>11) Chart Your Competitive Position</p>	<p>12) Determine the Customer's Decision-Making Unit (DMU)</p> <p>13) Map the Process to Acquire a Paying Customer</p> <p>18) Map the Sales Process to Acquire a Customer</p>	<p>15) Design a Business Model</p> <p>16) Set Your Pricing Framework</p> <p>17) Calculate the Lifetime Value of an Acquired Customer (LTV)</p> <p>19) Calculate the Cost of Customer Acquisition (COCA)</p>



# But First Let's Review the Quiz

## What & Why

1. Market Segmentation
2. Beach Head Market
3. End User Profile
4. TAM for BHM
5. Persona
6. Use Case
7. High Level Prod Spec
8. Quantify the Value Proposition
9. First 10 Customers
10. Define your Core
11. Competitive Position
12. DMU
13. DMP
18. Map of Sales Process



# Now Building Off This ... the Topic for Today is “How Do You Make Money Off Your Product?”

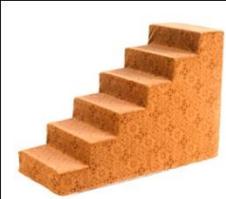


# Step #15: Designing a Business Model

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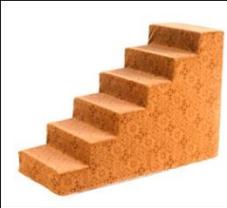
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# What Types of Business Models are there to Capture Value?

- One Time Upfront Charge (plus maintenance)
- Licensing
- Subscription/Leasing
- Shared Savings
- Consumables
- O&M (Operating and Maintenance)
- Cost Plus
- Upsell high margin add ons
- Advertising
- Transaction %
- Freemium
- Cell Phone Plan (or PPA in energy)
- Utility model (per usage)
- Franchise model
- Micro-transactions
- Parking meter
- Other

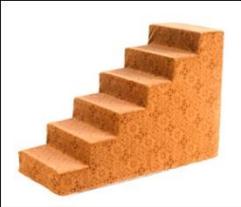


# Does It Make a Big Difference?

- iTunes
- Google
- Salesforce.com
- EnerNOC
- Blockbuster
- LinkedIn
- Amie Street
- Datatel
- Gillette
- Hewlett Packard
- Electronics Stores
- Intralinks
- Others?

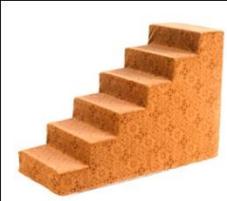
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# Step #17: Calculate the LTV

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# Conceptually

- How much a new customer is worth to your venture over the life time with you

$$LTV = \sum NPV \text{ (Profits for 5 years)}$$

- Key considerations
  - ▶ Gross Margins (Pricing & Costs)
  - ▶ Cost of Capital
  - ▶ Retention Rate
  - ▶ Ability to Upsell or Capture Value in other Dimensions
  - ▶ *Note that Profit is what matters and not Revenue*
  - ▶ *Skok's Law: LTV must be at least 3X COCA*

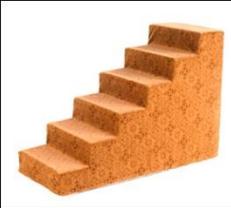


# Action

- Carefully review reader and example in the reader

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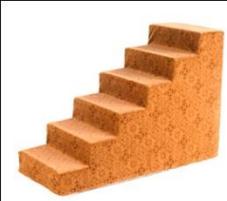


# Step #19: Calculate the COCA

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# Deeper Dive on COCA

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

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# More Precisely ...

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

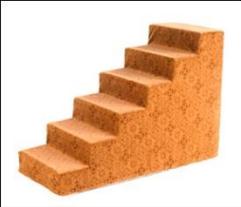
$$\$150K * (6 \text{ months}/12 \text{ months}) * (1/20) = \$3,750$$

- But there is more ...



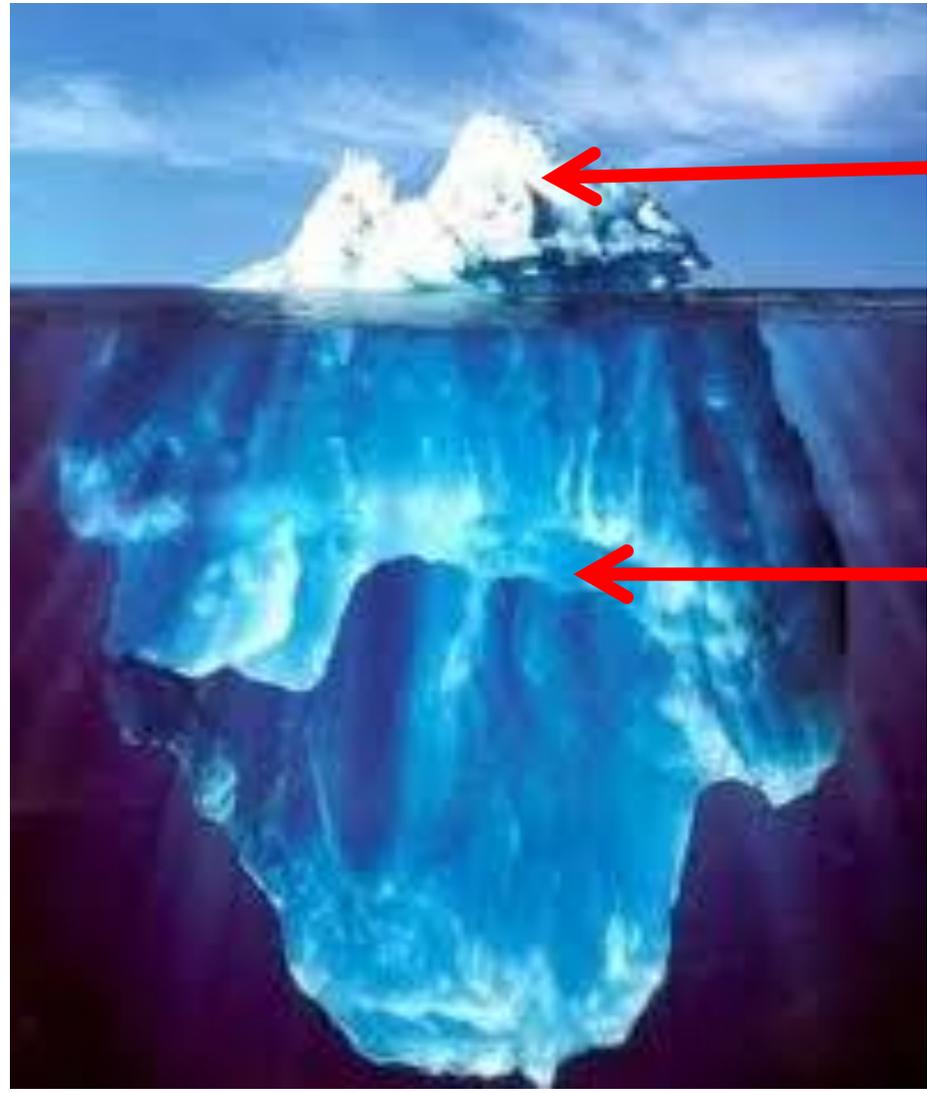
# Additional Sales Costs ...

- 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.**
- 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 the COCA =  $\$3,500 + \$1,000 + \$1,500 =$  **\$6,250**, right?



# Wrong!

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\$6,250

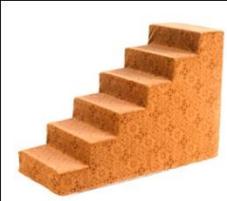
~20X

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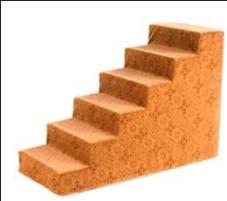
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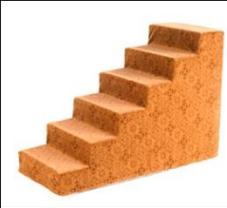
# How is That?

- 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
- 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 II

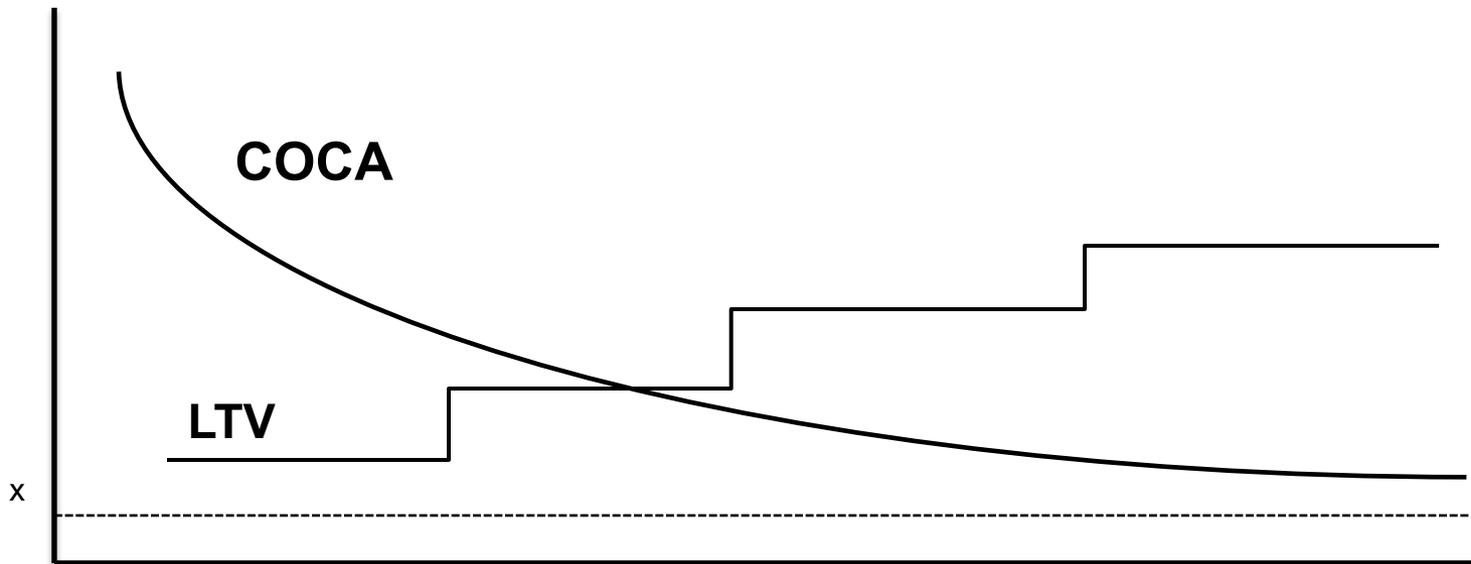
- Next, you determine if there is a substantial amount of the  $TMSE(t)$  that is dedicated for customer retention, e.g., customer support on going customers and we will call this **IBSE(t)** for Install Base Support Expense for time period  $t$ .
- We will then determine the number of new customers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

- Then the equation to calculate the COCA for any given period is:

$$\text{COCA}(t) = (\text{TMSE}(t) - \text{IBSE}(t)) / \text{NC}(t)$$

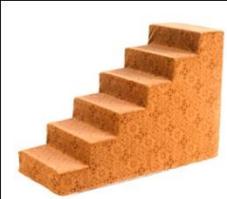




# It Is Very Important to View COCA Over Time

- It will start out very high and then it should go down over time

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# COCA Key Factors

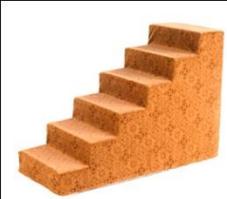
- Direct Sales vs. Telemarketers
- High Touch vs. Automated
- Conversion Rate
- Cost of Leads
- Quality of Leads
- Moving them Down through the Sales Funnel
- Design of Your Business Model
- WOM
- Focus => Decrease Sales Cycle

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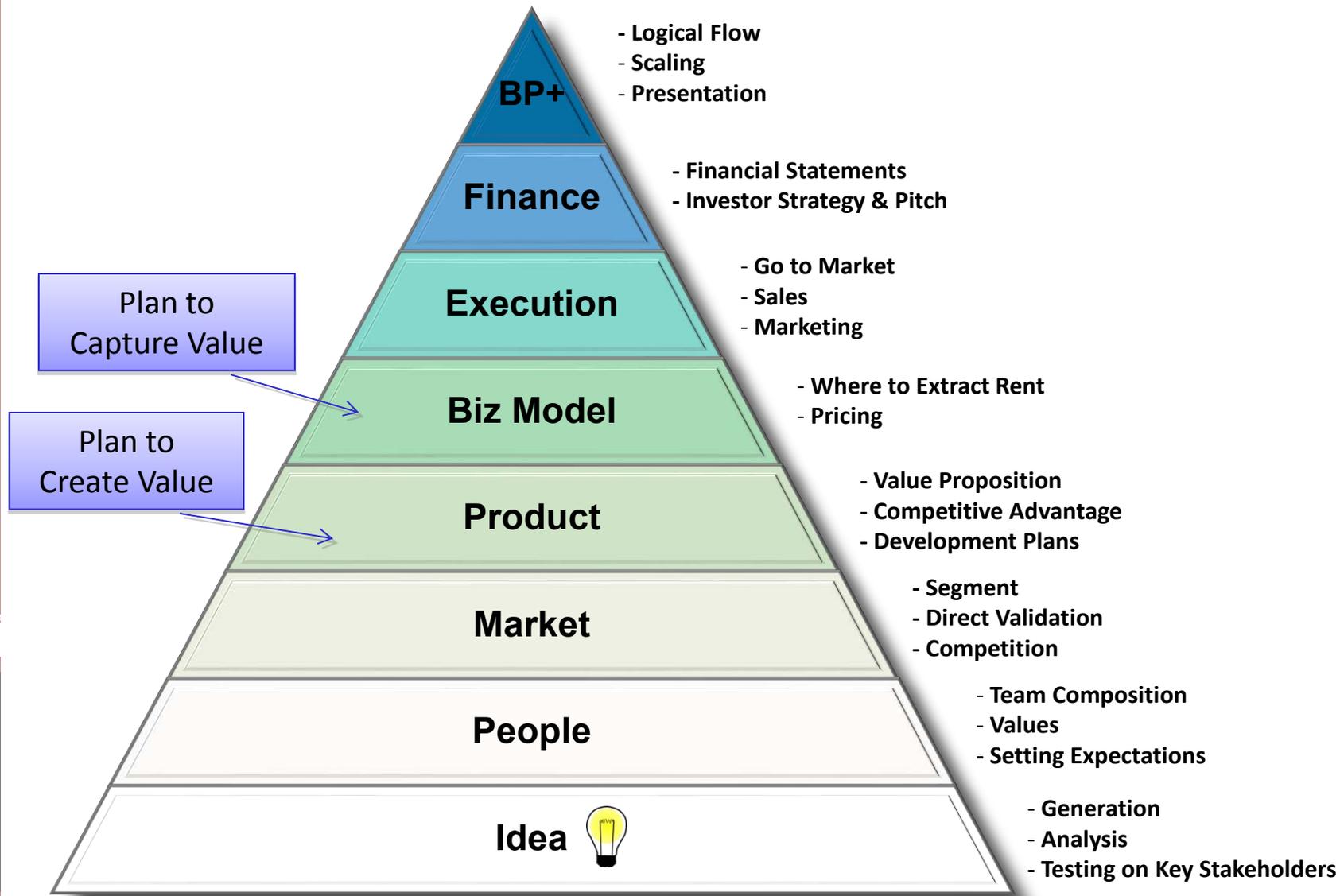
# Action Items

- Calculate it to Start
- Now will iterate
- Understand and revisit DMU
- Understand and revisit DMP
- Think creatively about your business model
- Inbound Marketing
- Automate where ever possible
- Read David Skok blog
- Outsource?



# Logical Flow of Course

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