Step 19: Estimate the Cost of Customer Acquisition (COCA) Worksheets

Worksheets

Assumptions for COCA Estimation

a. What was the time interval you defined for the following phases in Step #18, Worksheets Section, Item II?
    1. Short Term ______140 Euro
    2. Medium Term __370 Euro
    3. Long Term ______556.9 Euro

Total Sales and Marketing Expenses List

List the expected sales and marketing expenses, and their costs. This input will be used when estimating the cost of customer acquisition.

Sales Expenses	Short Term	Medium Term	Long Term
Cost for Device -140 Euro **Inventory – 1000 x 140 = 140 000 Euro** **Warehouse Costs Low (less than 5k a year) due to small compact size**	**145,000 Euro (1000 Units)**	**355,000 Euro (2500 Units)**	**705,000 Euro (5000 Units)**

Marketing Expenses	Short Term	Medium Term	Long Term
Revenue x Marketing Percentage (25%)	**70,000 Euro**	**350,000 Euro**	**1,400,000 Euro**

Estimate the Cost of Customer Acquisition (COCA)					
	Time Period (default is year but can change)				
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
New Customers forecasted	**1000**	**3000**	**5000**	**10000**	**20000**
All Sales expenses for period	**145,000**	**425,000**	**705,000**	**1,400,000**	**2,800,000**
All Marketing expenses for period	**70,000**	**210,000**	**350,000**	**700,000**	**1,400,000**
Total Marketing & Sales expenses for period	**215,000**	**635,000**	**1,055,000**	**2,100,000**	**4,200,000**
COCA for the period	**215**	**211**	**211**	**210**	**210**

Convert Estimation into Short, Medium and Long Term

Understanding these numbers are not precise, create a range you are comfortable with for the short, medium and long term (as defined in I(c) above) from the worksheet above.

1. **Short Term COCA Range ______________215____________**
2. **Medium Term COCA Range ______________211___________**
3. **Long Term (steady state) COCA Range _________210_____________**

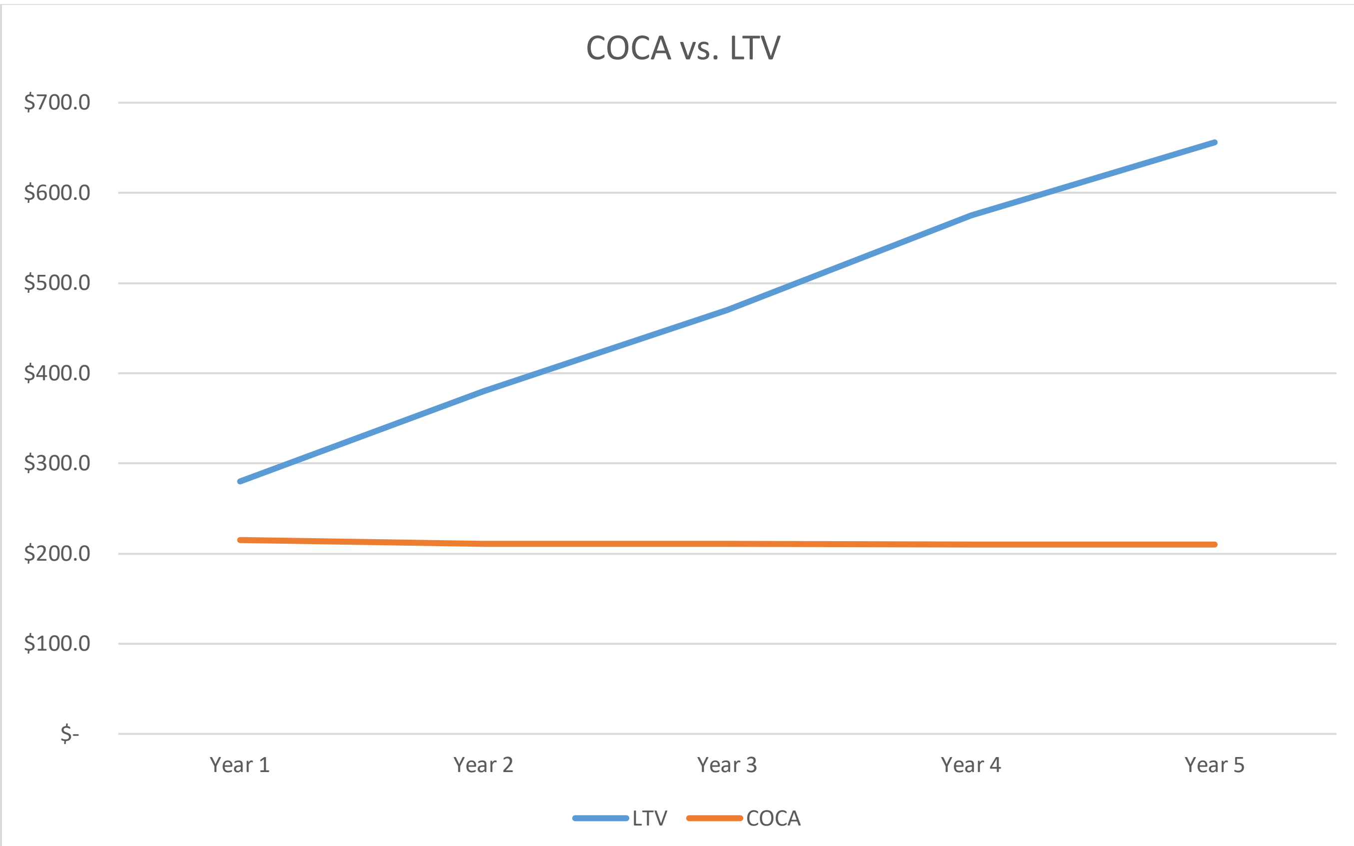
Key Drivers of COCA and Ways to Decrease It				
#	**Item**	**Effect**	**Action Possible to Decrease**	**Risk**
1	Production/Inventory Cost	HIGH	Find ways to make the product cheaper, since larger batches cost less	Low, the product supply might be affected negatively, and lose meeting demand if factory production is offset
2	Marketing	Medium	Marketing Costs can be decreased when we identify which platforms are more profitable to get customers from, therefore our COCA will reduce by investing more in that platform for advertising etc.	Low – Don't put all our eggs in one bask

Example: Key Drivers of COCA and Ways to Decrease It				
#	**Item**	**Effect**	**Action Possible to Decrease**	**Risk**
1	Field Sales	High	Decrease number and increase Inside sales	High in short term – need to see how market adopts product; lack of direct sales people will definitely slow adoption
2	Field Sales internationally	High	Use third-party resellers	Low in short term/High in long term because we don't have direct connection with customers
3	Advertising Budget	Medium	Build up in-house social media and other capability	Medium but probably worth it in long term
4	Field and Inside Sales	Medium	Supplement and reduce numbers with stronger Internet sales investment	Medium in short term and if works, low in long term
5	Tradeshows	Medium	Eliminate and find a guerilla market approach at 10% of expense	Medium in that our customers expect us to be at these shows and it gives our company credibility; Still something can probably be done here

Comparison of LTV and COCA Over Time

Label the axes with the appropriate numbers and units, and then plot the LTV and COCA on the graph based on your calculations from this step and from Step 17, Calculate the Lifetime Value (LTV) of an Acquired Customer. Draw a line to connect the three LTV points, and another line to connect the three COCA points.

(Editable version of the graphic below is available in additional Powerpoint document)



Overall Interpretation of Unit Economics – Bringing it All Together

Now you have done all the hard work, let's pull it together and consolidate what we know and what we should do now.

A. Basic 3X Test: Is your LTV more than 3 times your COCA for your long-term time period? This is essential because COCA only deal with marketing and sales. The LTV must produce enough excess profit to also pay for research and development (R&D) as well as general and administrative (G&A) costs. The R&D costs can be significant. The 3X rule of thumb was created for software as a service companies, so the specifics of your industry may require a higher ratio in order to be successful. Does your LTV to COCA ratio clear the basic 3X threshold by a little, a reasonable amount, or a lot?

___Yes it does, just a bit higher than x3________________________________

B. **R&D Factor:** Is your R&D expense going to be above or below that of an average software as a service company? For instance, a biotech company's R&D expenses will be much higher. If so, then your ratio needs to be higher to compensate for this. For biotech companies it can be over 100x and for consumer goods, it can be less. What is your situation and do you feel comfortable there will be enough profit to cover R&D expenses? (G&A expenses fluctuate as well if there is a regulatory component but they do not fluctuate as much as R&D so we will focus on R&D as the proxy for G&A as well):

   As number of sales increase, the profit margin is gets even larger, as this is a low estimate of our COCA, since we don't account for reduction in manufacturing costs and higher market reach, and it is sufficient enough to allow for our R&D stage.

Adjustments May Be Necessary But You Are Ready: There is a good chance that your initial unit economics don't work. Don't overreact and don't underreact. You are prepared now to go back and iterate. Go back and make adjustments like you started to list in the Key Drivers of COCA worksheet. Make adjustments until the numbers work. It is great to be passionate and that is essential, but well thought-out numbers have a stubborn way of telling the truth in business. Don't ignore them. If in the end, you can't make the unit economics work, you won't have a sustainable business no matter how hard you try. But most of the time you can fix it now that you are equipped with this knowledge.

Once you have iterated and the plan works, like in Step 18, list the top 3 risk factors for the unit economics and how you plan to deal with them below:

1. COCA Risk Factor #1 and Mitigation Plan:
   High Inventory Costs, Sales need to match expected outcome
   Metrics to Watch: Sold Products
   Potential Intervention Strategy: Improve Marketing Efficiency, Stop Production

2. COCA Risk Factor #2 and Mitigation Plan:
   Cancelled Subscriptions
   Metrics to Watch: Cancelled subscription numbers
   Potential Intervention Strategy: Change Terms of Service, Reduce Subscription Price, Collaborate with other services for joint subscription fees

3. COCA Risk Factor #3 and Mitigation Plan:
   Changes in Warehouse Costs
   Metrics to Watch: Price of storage per unit
   Potential Intervention Strategy: Build or Rent out our own Warehouse once high revenue starts to flow in

If you are an engineer like me, you are now getting to the fun part. Now we can build the product with confidence that it can be the basis of a great company. That being said, it all makes sense but we are not sure until it really happens. Now we move to the design and build stage in Step 20, Identify Key Assumptions.