Innovation Process

Product Strategy

How do you make money off your product?

LEARNING OUTCOMES

- Understand what is a business model.
- Calculate the lifetime value of an acquired customer and cost of customer acquisition.
- Understand what is *minimum viable business product* (MVBP).

How do you make money off your product?

WHO IS YOUR CUSTOMER?

1 Market segmentation

2 Select a beachhead market

3 Build an end-user profile

4 Calculate the TAM size for the beachhead market

5 Profile the persona for the beachhead market

9 Identify your next customers

WHAT CAN YOU DO FOR YOUR CUSTOMER?

6 Full life cycle use case

7 High level product specification

8 Quantify the value proposition

10 Define your core

11 Chart your competitive position

HOW DOES YOUR CUSTOMER ACQUIRE YOUR PRODUCT?

12 Determine the Customer's Decision Making Unit (DMU)

13 Map the process to acquire a paying customer

18 Map the sales process to acquire a customer

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)

HOW DO YOU DESIGN & BUILD YOUR PRODUCT?

20 Identify key assumptions

21 Test key assumptions

22 Define the minimum viable business product (MVBP)

23 Show that "the dogs will eat the dog food"

HOW DO YOU SCALE YOUR BUSINESS?

14 Calculate the TAM size for follow-on markets

24 Develop a product plan

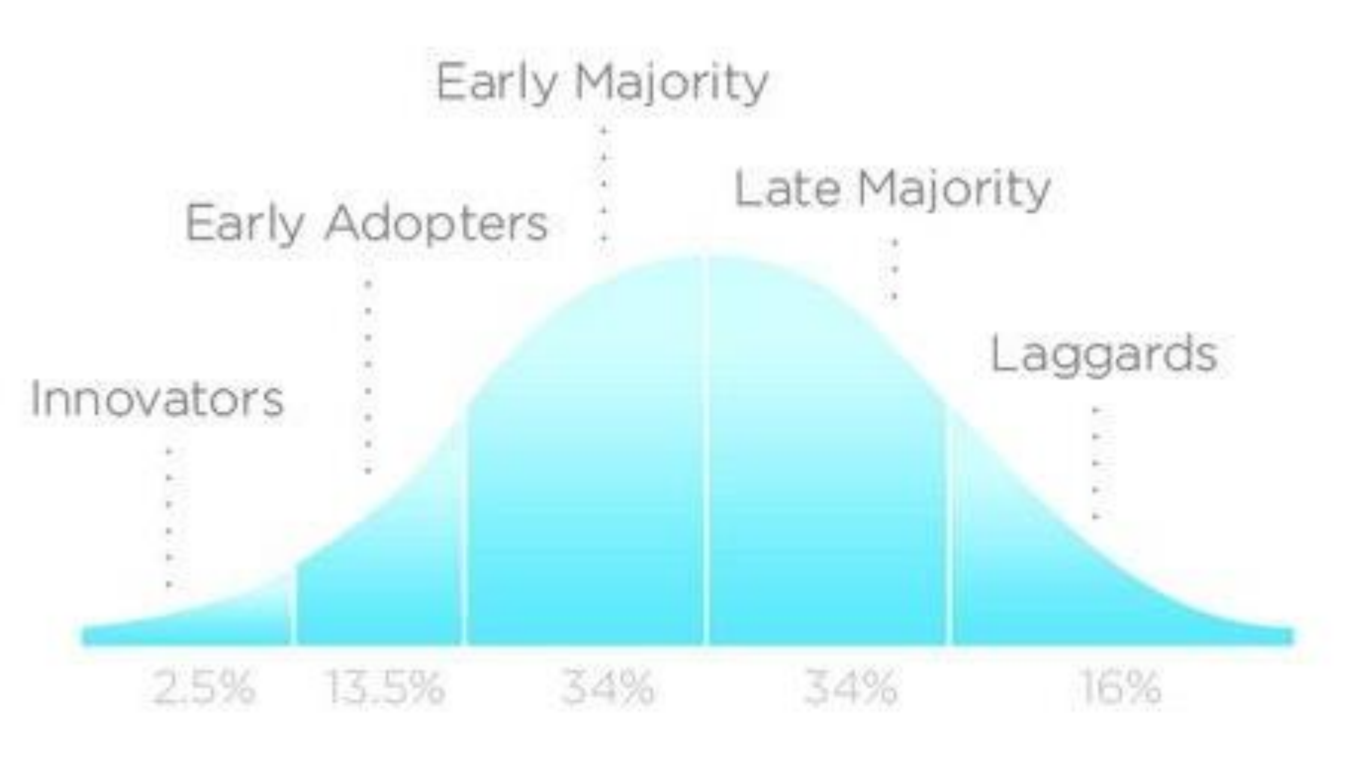
How do you make money off your product?

- A **business model** is a framework by which you capture some portion of the value your product creates for your customers.
- While business model is about how you plan to charge your customers, pricing is how much you charge them.
- Choice of business model has a direct impact on your profitability.
- When pricing your products, the following points have to considered;
  - Price the product based on the value the product creates than on the cost of the product.
  - Understand the customer's willingness to pay.
  - Understand the prices of customer's alternatives.
  - Different types of customers pay different prices; Technology enthusiasts are willing to pay higher prices to get instant access to the products. Early adopters are price inelastic. Capturing early majority helps the company scale and the pricing strategy has to be planned and laid out keeping them in mind.

Innovation Adoption Lifecycle

- 5 types of adopters for innovation: **innovators**, **early adopters**, **the early majority**, **the late majority** and **laggards**.

- Understanding where these fit into the product-life cycle can enable selective marketing and design activities which are focused on tapping into these adopters' specific needs. This can improve a product's chances of success.



- Calculate the unit economics to understand how profitable your business will be in the beachhead market.

- In order to do this, you have to estimate the Lifetime Value of the Customer (LTV) and the Cost of Customer Acquisition (CAC).

Lifetime Value of the Customer (LTV)

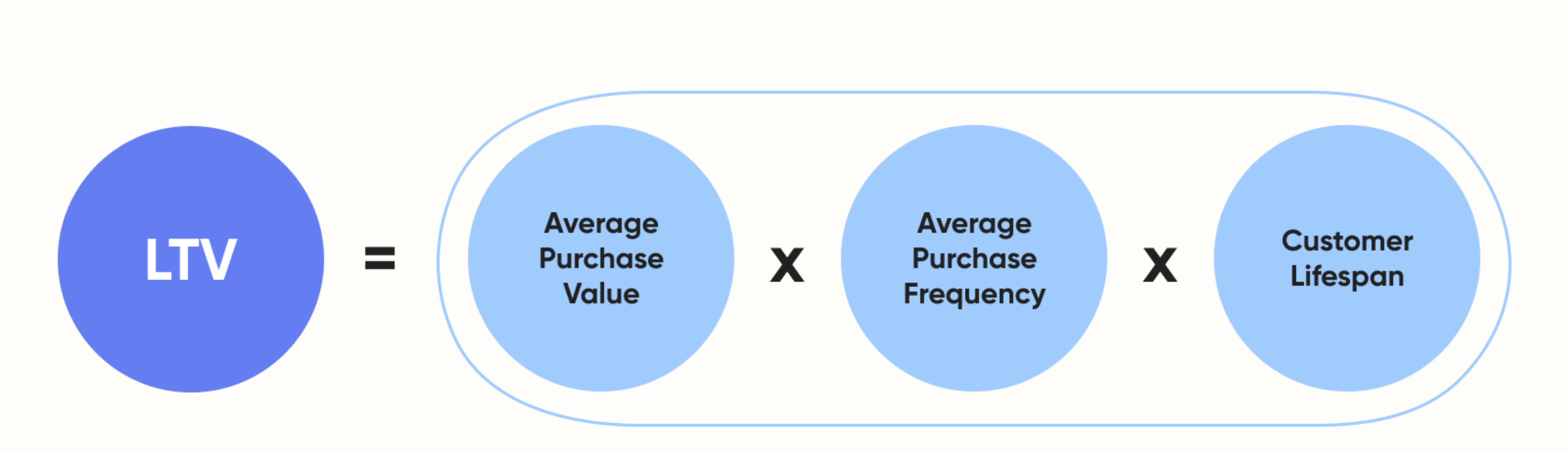
- LTV is the net present value of profits per customer discounted with cost of capital, generally calculated for 5 years. Beyond a 5-year period, the compounded cost of capital negates the profits. Key inputs to calculate LTV are – revenue, gross margin, retention rate, cost of capital.

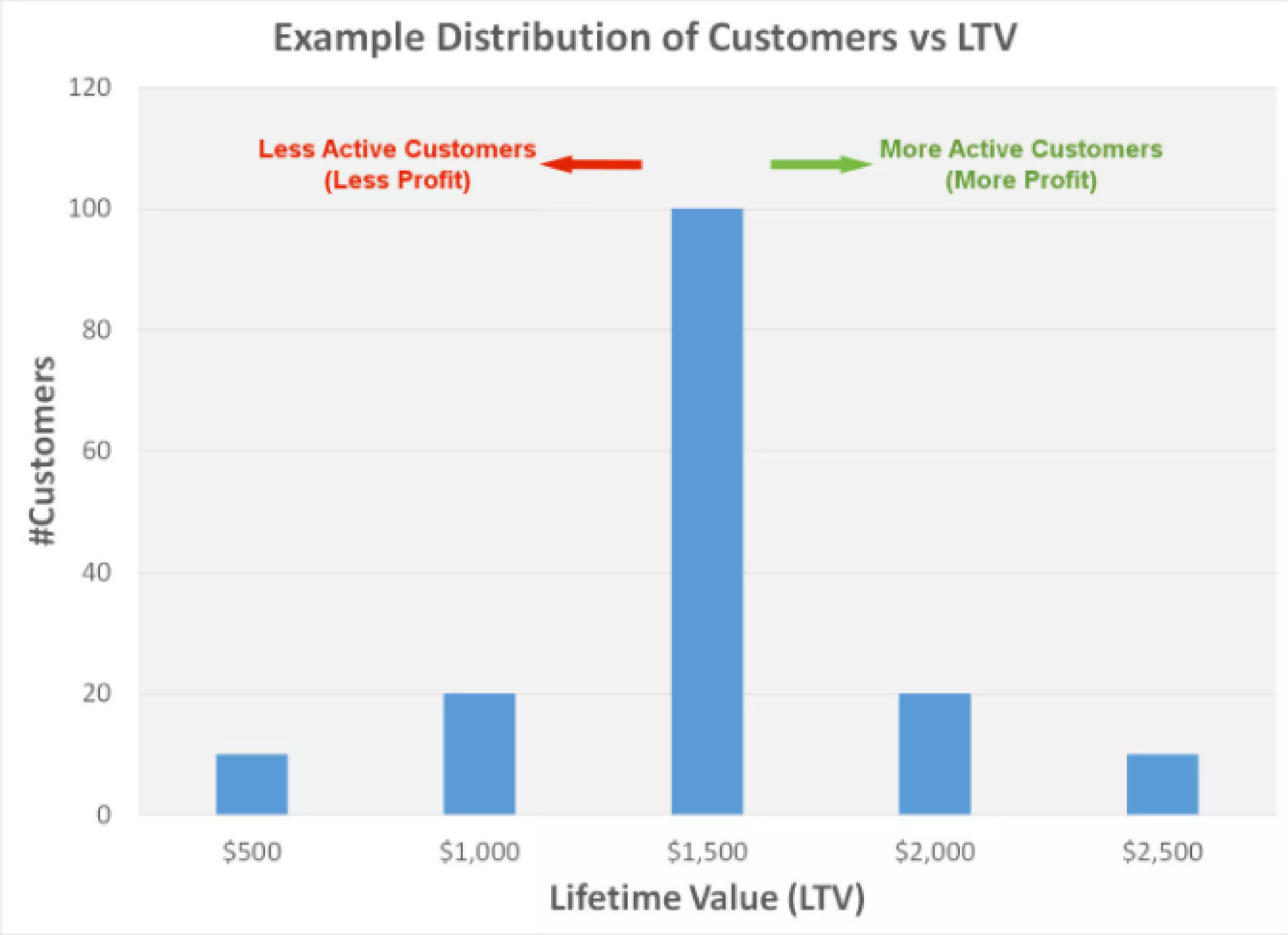
- LTV in itself will not indicate the attractiveness of the business. It has to be considered along with CAC *(Cost of Customer Acquisition)*. Rule of thumb for SaaS businesses *(Software as a Service)* for an LTV to CAC ratio is 3:1.

- Business owners and marketers are always looking to boost profits by finding the most cost-effective ways to acquire new customers and improve existing customer relationships.

- Knowing how to calculate the *lifetime value* (LTV) of a customer is crucial to understanding how to maximise the return on investment in marketing, product development, and customer support.

- Projecting the lifetime value of a customer provides business owners with important insights for decisions about:
  - **Product development:** LTV metrics factor into decisions on how to incorporate customer feedback into product development. For example, you can decide whether it is cost effective to make major product changes to satisfy the demands of a small segment of the customer base.
  - **Marketing**: Knowing the LTV of a customer can help determine whether acquiring new customers provides a sufficient return on investment (ROI). The marketing strategy is ineffective if the marketing costs to acquire a new customer exceed the LTV.
  - **Customer Support**: Increasing customer satisfaction is statistically one of the best ways to retain your most valuable customers and increase LTV. According to the Harvard Business Review, it is 5 to 25 times more expensive to acquire a new customer than it is to keep a current one.



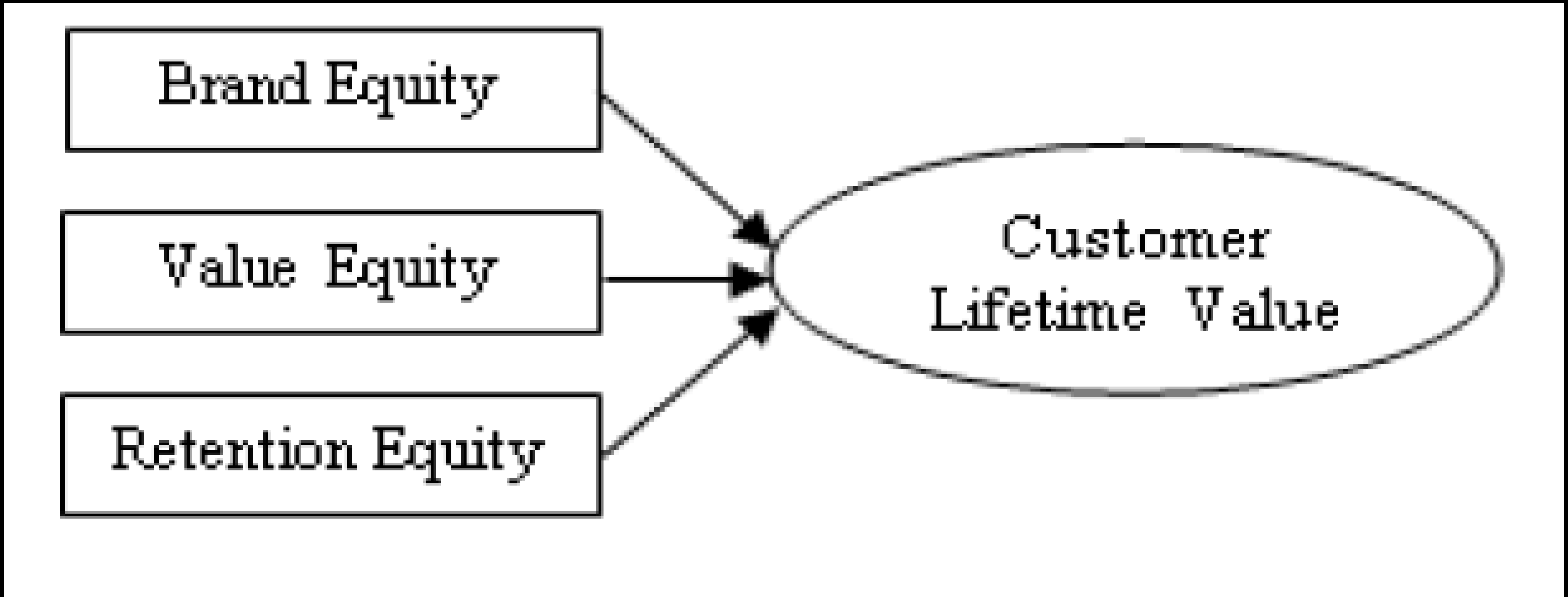


Lifetime Value Chart. (c) Dave Mcleod/Susan Ward

Lifetime Value of the Customer (LTV)

- We can therefore refine the LTV calculation using an average of the customer distribution. In the above chart example, the sum of the LTV for all customers would be:
  - **(10 x RM500) + (20 x RM1,000) + (100 x RM1,500) + (20 x RM2,000) + (10 x RM2,500) = RM240,000**

- Dividing by the total number of customers gives us an average LTV:
  - **Average LTV: RM240,000 / 160 = RM1,500**



Cost of Customer Acquisition (CAC)

- **CAC** is the total sales and marketing expenses your company incurs to acquire customers divided by the number of new customers acquired.
- This should also include the expenses that you incur to reach out to people who didn't turn out to be your customers.
- If a portion of expenses are dedicated to retaining customers, that amount has to be deducted from the total sales and marketing expenses.
- Typically, in early stages of the company, CAC will be higher than LTV, you lose money with every new customer you acquire. For sustainable businesses, CAC gradually decreases over time until it is substantially less than LTV.

- For example, if you spent RM15,000 in the past month to acquire new customers (including marketing, sales, salaries, and overhead costs) and had 1,000 purchases from new customers, your CAC would be RM15.

Formula for Customer Acquisition Cost (CAC)

- Sales and marketing expenses are the advertising and marketing spend, commissions and bonuses paid, salaries of marketers and sales managers, and overhead costs related to sales and marketing over the measurement period.
- Number of new customers is the total number of acquired customers over the measurement period.

Marketing Data for ABC Company		
Marketing Campaign	Cost	Acquisitions
Marketing Campaign Q1 (Jan - Mar)	$5,000.00	1,000
Marketing Campaign Q2 (Apr - June)	$5,500.00	1,500
Marketing Campaign Q3 (July - Sept)	$6,000.00	2,000
Marketing Campaign Q4 (Oct - Dec)	$4,000.00	950

EXAMPLE

The CAC for ABC Company over the last year is calculated as follows:

$$CAC = \frac{\$45{,}000 + \$5{,}000 + \$5{,}500 + \$6{,}000 + \$4{,}000}{1{,}000 + 1{,}500 + 2{,}000 + 950} = \$12.02$$

Define the Minimum Viable Business Product (MVBP)

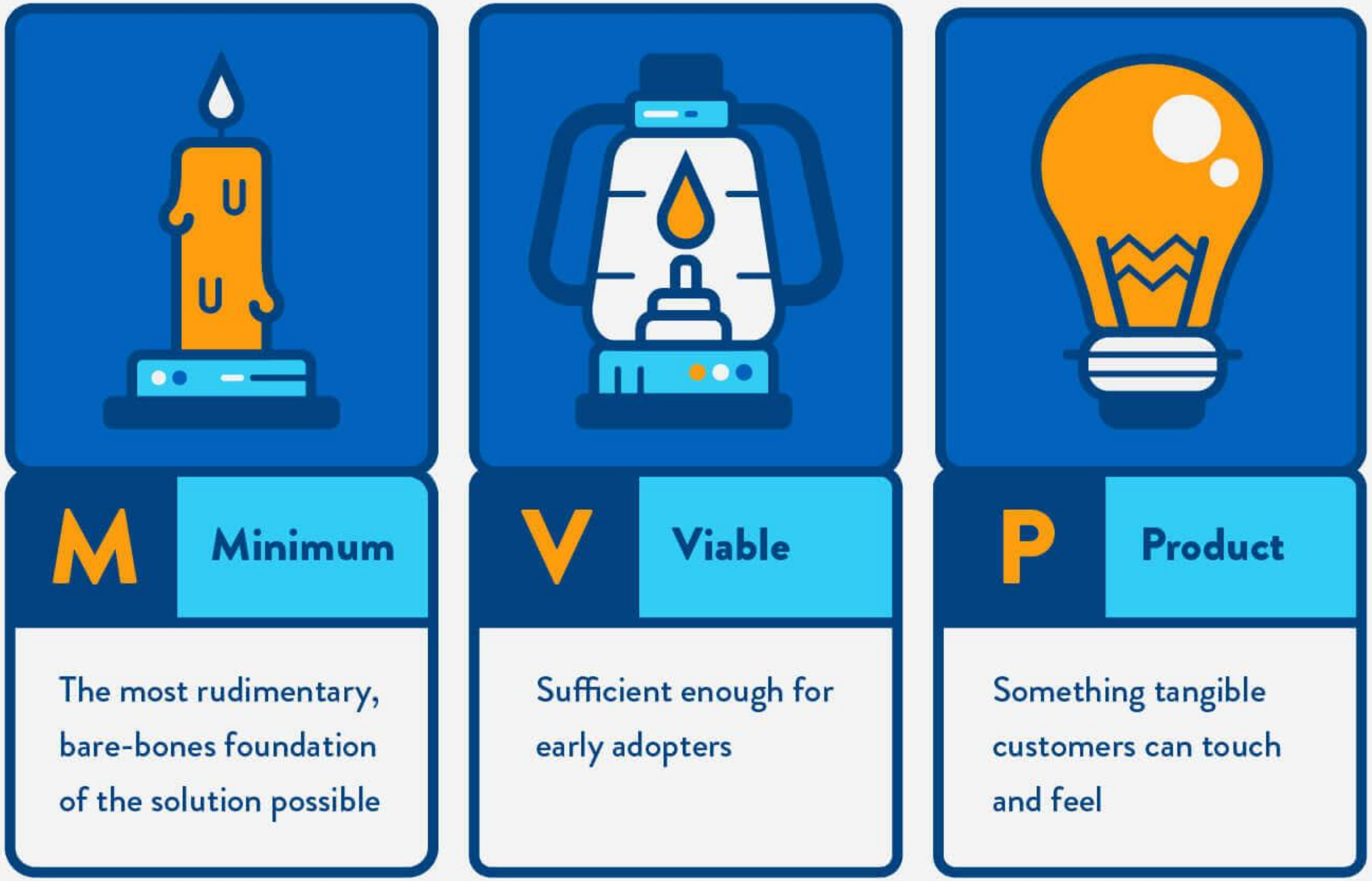
- **What is MVBP?** This is the minimum product that you can use to test if your end user gets value from your product and whether the economic buyer is willing to pay.

- The idea is that first to develop a minimum product. Then share it with your customers to get feedbacks. Based on the feedbacks, the product could be improved. Iterate this process.

- To create an MVPB, your goal is to do the least amount of work possible to achieve three key objectives:
  - The customer gets value out of your product.
  - The economic buyer pays for the product.
  - The product is sufficient to start the customer feedback loop, where the customer can help you iterate toward an increasingly better product.

- While the MVBP is minimal, the customer should see it as a product at this point. Your MVBP should balance simplicity with sufficiency.

Show That "The Dog Will Eat the Dog Food"



- In this step, you take your MVBP/MVP, offer it to your target customer and test whether the MVBP will be accepted and paid by your target customer.
- Collect data to see if they are really using it and how engaged they are as users.
- Therefore, the ultimate test now is whether the end user is using the product and getting value, the economic buyer is willing to pay.

Case Study for Online Forum 5

- Select one of the startup, discuss on their business model and pricing strategy.

  – Source to be referred: https://startuptalky.com/top-singapore-startups