Case 2: GoNet Internet Service Provider

By: Adam Borchert and Joep Knijn (Tuck Class of '04), Edited By: Mauricio Atri (Kellogg Class of '12)

Case Question

- Our client, GoNet, is a US-based Internet Service Provider (ISP) that is considering entering the European market. They are currently the dominant player in the US with two revenue streams: a subscription access fee and by taking a percentage of all e-commerce transactions from subscribers.
- Examining the European market, GoNet has found that the market is highly fragmented and ripe for entry. You are going into a meeting with the CEO and have been asked to perform some quick "back of the envelope" calculations to determine the potential profitability of entering Europe.

8
Quants.

4
Structure

Market entry, market share

Case tracker

- **Industry:** Technology
- **Level of Difficulty:** Medium
- **Case format:** Market entry
- **Concepts being tested:**
  - Market share

Fit Questions

Spend first 15 min on fit

- How competitive are you?
- What do you believe is the downside of
- What sorts of things irritate you the most or get you down?

Guide to interviewer

- This is a very quantitative case that requires the interviewee to run the numbers on European profitability.
- The candidate will need to ask for additional information to solve the problem. After getting the initial calculations right, there will be a number of market changes the interviewee will have to react to.
- After the quantitative portion is completed, there are some open-ended questions for the candidate to answer.

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Clarifying answers and case guide

Clarifying answers to provide

(Provide this information on request)

Competitive dynamics

- Highly fragmented industry
- No information about market leaders or trends

European industry overview

- GoNet plans to capture a base of 10 million subscribers
- Subscriptions will cost $20/month
- The average GoNet subscriber purchases $1,800 of goods on the internet annually
- GoNet receives 3% commission
- Fixed costs are $1 billion annually
- Variable costs are $110/subscriber annually

Guide to case

Part 1 – Quantitative discussion

- This should be the meat of the case and should be completed before discussing any general or qualitative responses.

Part 2 – Qualitative discussion

- After navigating the math, ask the candidate the following questions:
  - 1) How could we reduce the fixed costs of investment?
  - 2) Would there be any reason to continue with the investment even if it looks like it will lose money?
  - 3) Are there are any other risks/benefits that GoNet should consider?
  - 4) How would you sum up the situation and what is your recommendation?

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Math questions (1 of 2)

Math question

- 1) Please determine the annual net income (before taxes) in Europe, given the current revenue model and set of assumptions. What is the annual gross mark-up, in percentage?
- 2) GoNet just found out that a new entrant is charging $10/month and capturing market share. Can we lower our fee to $10/month?

Math solution

- 1) Revenues each year will be $2.4B for subscription (10 million subscribers X $20/month X 12 months) and commissions will be $540M (10 million subscribes X $1,800/year X 3% commission) for a total of $2.94B.
  - Fixed costs are $1B and variable costs are $1.1B (10 million subscribers X $110/year) for a total of $2.1B each year. Profits are $840M and the annual profit margin is 40% ($840M/$2.1B)
- 2) Annual revenues drop to $1.2B (10 million subscribers X $10/month X 12 months) from subscriptions, while commissions remain constant at $540M. Total revenues are $1.74B. Because total costs remain $2.1B, we lose $0.36B by halving subscription charges, making the answer "No."
  - At this point, ask the interviewee what the elasticity of demand is in this market and the implications for GoNet. The market should be highly elastic, meaning that GoNet will not win over enough subscribers at $20/month.

Math information

- 10 million subscribers
- $20 month subscription fee
- $1,800/year of online spending @ 3% commission
- Fixed costs: $1 billion
- Variable cost: $110/year per subscriber

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Math questions (2 of 2)

Math question

- 3) With high market elasticity, GoNet will not be able to charge more than $10/month. How much would each subscriber have to buy on the Internet to keep profits at the same level as $20/month subscription fees?
- 4) How much would each subscriber have to buy on the Internet to enable us to break even?
- 5) Given that we cannot charge more or realistically increase shopping significantly, how many subscribers would we need in order to break even?

Math solution

- 3) To keep profits at $840B, we know that costs remain at $2.1B so revenue will need to be $2.94B. Subscription revenue will be $1.2B, so commissions need to be $1.74B. There are 10 million subscribers, so each subscriber need to bring in $174/year of commission. At 3%, they will need to buy $5,800/year in goods ($174/3%).
    - Ask the candidate if this realistic. The answer should be no.
- 4) To breakeven, we will need commission to be $900M over 10 million subscribers. That is $90/year per subscriber ($900M/10M), which means $3,000/year in goods purchased online ($90/3%). The candidate should identify that this is also unrealistic, representing more than a 50% increase from last year.
- 5) To find the answer here, we need to find incremental revenue per subscriber. Each subscriber brings in $174/year ($10/month X 12 months + $1800/year X 3%) at a cost of $110/year for a profit of $64/year. These profits must cover the fixed costs of $1B/year, so we must bring in 15.625 million customers ($1B/$64)
    - Note: many people forget the variable costs during the completion of this case.

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Solution and recommendations

Solution & Recommendations

Responses to the open-ended questions:

- 1) Some potential ways (not exhaustive) to reduce fixed cost: outsourcing capacity, leasing networks, working in specific geographies, etc.
- 2) GoNet may still be interested in this move as a way to break into Internet retailing and expanding its subscriber base. Based on the math though, this should not be an attractive option long-term either.
- 3) Very open ended and reliant on candidate's creativity.
- 4) This is very open-ended and should be evaluated based on the candidate's argument, not answer. Based on initial estimates, this is a very attractive market to enter, but with price pressures and high elasticity the market is far less attractive. If we are to undertake this initiative, GoNet needs to find ways to convert a much higher number of customers or differentiate its product, which both require market research. There is also potential to reduce costs or establish this foothold as a loss leader, but these require strong arguments from the candidate.

Bonus/Guide to an Excellent Case

- This case tests two things – the interviewee's comfort with numbers and ambiguity. An excellent case interview will result in an intuitive grasp on what is being asked quickly and solid execution on the quantitative portion of the case.
- Ultimately, the best interviewees will make a very strong argument using the facts provided and support the decision to invest/not invest with a strong business sense about the costs and implications of the project.
- Creative solutions beyond those listed are possible and encouraged, though should be done within the framework of the information available.

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