IDEA Business Model Guide Fall 2016

The objective of building a business model is to commercialize a new product or service. To do this you will need to define a revenue model, the process to generate revenue either directly from customers or indirectly from sources like partnerships and advertisements. A business model must also address the resources needed to produce the revenue. A resource model includes strategies for R&D, manufacturing, selling/distribution, and customer support.

Note: Please read the entire guide before getting started. This is not simply a step by step process and some sections may not apply to your business. Business model development requires that you consider all parts of the process while you work on any one section and that you adapt the basic principles to your specific situation. In the event you are beyond the conceptual planning phase in your business, use this as a guide to reexamine the activity you have done thus far. If you have questions at any time please contact your coach for assistance.

Foundation Work for Venture Teams: Continue/expand customer interviews to further define characteristics of the minimum viable product ("MVP")?

Using the solution developed in the Solution Design phase, speak with more customers (minimum of 10) that are <u>representative of your target group(s)</u> to determine the following in details:

- **Minimum Feature Set** - What is the most simple form of the product or service that customers see significant value in?
- **Customer**: who is the buyer versus the user? (In b to b business, this is typically two different people.
- **How to reach customer**: Where and how does the customer learn about products or services similar to what you are selling?
- **Delivery preferences** - How and where do customers want to consume the product or service?
- **Service requirements** - What support will customers require to feel confident in using or purchasing this product or service?
- **Pricing** – What price is a customer willing to pay and how will they measure value?
- **Social Impact** (if any)- For those ventures with a social component/mission. What is the impact and how do those affected view that impact?

Once this is completed, proceed next to Revenue and Resource Model Definition

PART 1 (A): Revenue Model Definition

Revenue Model: How will you make money?

- **Who** is the “customer”, e.g. the buyer of the product or service? Is it the same as the “user”?
- **Purchase structure**: How do these customers pay - A one time price or fee? A recurring subscription for a service? Is it an online purchase or in person?
- **Price**: What is the price paid, and how does this compare relative to competitors (e.g. premium, mid range, low cost).
- **Velocity**: What is included in the base price? Are there add ons?
- **Frequency**: How often - How frequently do customers say they will purchase?
- **Anticipated Margin** - What percentage of the sale price do you expect to retain as profit? (see appendix for definition)
- **Supplemental sources of income** to achieve financial sustainability, specifically for social ventures, where this might also include donations, corporate social responsibility grants, income-generating activities (IGAs) from mission related services

PART 1 (B): Resource Model Definition

Development: What will it take to develop the minimum viable product (“MVP”)?
- Timeline to MVP - Based on the minimum feature set you uncovered, what are the steps and timeline needed to produce the Minimum Viable Product?
  - Timeline to Additional Products/Services - If you plan on releasing additional products or services what are the steps and timeline needed to produce them?
- IP protection
  - Do you have any intellectual property that can be protected?
  - How will you go about protecting your intellectual property?
  - If the IP is University-generated, has the venture team secured access to that IP or is it in the process of getting a University license on reasonable terms?
- Development Resources:
  - Develop the headcount plan for timing and number of engineers/employees required to develop the product and for ongoing development.
  - Will you outsource all or parts of the development? Detail the timing and amount to be paid to third party developers.
  - Will you need to partner with other companies or government agencies in order to develop parts of the new product or service?

Production and Associated Costs: How will you produce the product or service?

- Where and who will produce the product? Will the product be manufactured by the venture or by a third party contract manufacturer.
- What is the timing and cost to ramp up manufacturing.
- Cost Structure
    - What is the Cost of Goods Sold? (see appendix for definition)
    - What is the cost of delivery and/or implementation?
    - What are the costs associated with service after the sale of the product?

Go-To-Market Strategy: How will you reach customers?

- **Sales Channels**
    - Most desireable - What channel presents the biggest opportunity?
    - Most accessible - What channel is the easiest path to enter the market?
    - First point of attack - Who will be your first set of customers?
    - When do selling and marketing activities commence?
    - If you are developing your own sales force, when do you start hiring, how many, and when?
- **Sales Funnel** (see Appendix for illustration)
    - What is the process from first contact with the customer to close a sale or acquire a user? What percentage convert from one stage of the sales funnel to the next, e.g. lead to qualified lead or initial sales contact to paying customer?   How can you prove the sales funnel in a fast, cost-effective manner?
    - If you are specifying multiple sales channels (such as direct sales and online sales), how does the sales funnel vary for the respective channels?
    - For a social venture, if NGOs, government agencies, or external stakeholders are involved in the purchase, what is the sales funnel for engaging with these partners?
- **Go to Market Action Plan**
    - Starting with your first set of customers, create an action plan that shows how you will begin to acquire users or sell products.
    - Be able to describe in detail how you will:
        - Build awareness of your product with target customers
        - Gain credibility with target customers
        - Create and sustain demand for your product or service
        - Convert demand into sales revenue
- **Marketing/Selling Costs**
    - Based on your Got to Market Action Plan, what are the associated costs for:
        - Marketing
            - Employee salaries
            - Digital Ads
            - Print Ads

            - Marketing Collateral
            - Contractors
            - Other
        - Sales
            - Employee salaries
            - Travel
            - Commission on sales
            - Other

Team for Implementing the Resource Model

List the people who are working in the following functional areas (be sure to note who is full time and who is part time):

    - Overall Operations Management
    - Sales and Marketing
    - Product Design or Software Development
    - Supplier / Contract Manufacturing
    - Finance / Accounting
- Rate your coverage in each area Strong / Average / Weak
- Describe your plan to address any weaknesses through recruitment. What type of people do you need to fill out the venture team? What should be their qualifications?

PART 2: Profit and Loss Statement / Unit Economics

Based on the strategy you developed in Part 1, use your assumptions about revenue and costs to determine the unit economics of your business. This will lead to a projection of revenue, costs, and operating profit -- a projected P&L for the venture. Think about the following questions:

- Based on the initial run rate of expenses, can the you earn enough revenue and margin to break-even or will you need to raise outside capital?
- Unit economics - is the gross margin (net selling price minus cost of goods sold, delivery and service) appropriate for this type of business?
- Based on Cost to Acquire a Customer and Lifetime Value of a customer, is your Go to Market plan feasible?

- **Profit & Loss Statement**
    - Work with your coach to fill out the Profit & Loss Statement excel template that shows projected revenues and expenses. See attached template.
        - Focus on answering the following questions:
            - 1) What kind of volume is required to get to breakeven and are your go-to-market programs effective enough to get you to those volumes or is your pricing / margin correct to support your business.
            - 2) How much negative cash flow from inception to breakeven is required to fund the venture. If the number is too big with no source of funds, how can you make this venture work?
- **Gross Margin Percentage**
    - (Sales Revenue - Cost of Goods Sold) / Sales Revenue = Gross Margin Percentage
    - Please perform this calculation based on the sale of one unit
    - This will also calculate on the P&L Template for quarterly/annual numbers
- **Cost to Acquire a Customer** or “CAC”
    - To calculate the CAC you’ll need to determine
        - What you expect to spend on marketing and sales in your Go To Market strategy
        - How effective you expect your marketing a sales strategy to be at acquiring customers (see Sales Funnel in appendix) i.e. for every 100 people who see your marketing, how many become paying customers?
    - A basic formula for CAC:
        - (All marketing and sales costs) ÷ (Number of customers acquired as a result of those costs) = CAC
        - For example, is you spent $100 on marketing and sales to acquire 100 new customers the equation would be: $100 marketing and sales / 100 new customers = $1 CAC
- **Lifetime value"** or "LTV" of a customer
    - To calculate LTV you’ll need to determine:
        - Average Monthly Revenue per customer
            - Based on your revenue model, what is the average amount of revenue you expect per customer each month?
        - Gross Margin per customer
            - Sales Revenue - Cost of goods sold = Gross Margin
            - (Sales Revenue - Cost of Goods Sold) / Sales Revenue = Gross Margin Percentage
        - Churn rate
            - The proportion of customers or subscribers who leave a supplier during a given time period. For example, If you had 100 customers at the beginning of a month and during that month 10 of them

cancelled their subscriptions, that equates to a 10% churn rate (10/100).

- A basic formula for LTV:
  - (Avg Monthly Revenue per Customer * Gross Margin per Customer * number of months you expect a customer to be paying for the product or service) ÷ Monthly Churn Rate

Pitch Outline: What should you present at the Business Model Pitch?

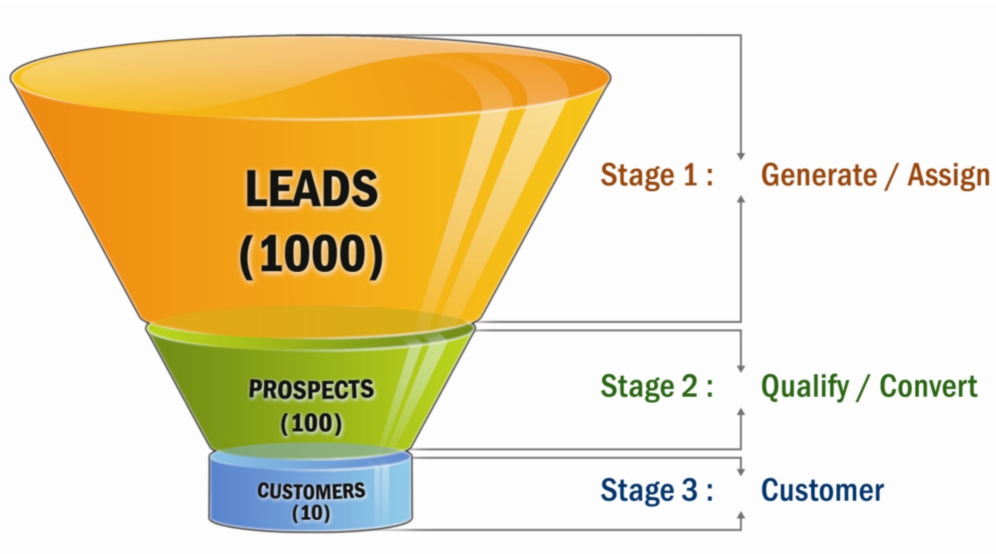
- Format: You will have 45 minutes to present and should prepare a short slide deck on the following required items:
  - Background
    - Value Proposition
    - Target customer
    - Solution
    - Team
  - MVP or Current Product
    - Minimum feature set
    - R&D Roadmap
    - Demo (If applicable)
  - Overview of Go To Market Strategy
    - Timeline & Milestones
    - 3 months / 6 months / 9 months
  - Financial Viability
    - Completed P&L Template
    - Gross Margin
    - Cost to Acquire a Customer
    - Lifetime Value of a Customer

Appendix:

Margin - In **accounting**, the gross **margin** refers to sales minus cost of goods sold. It is not necessarily profit as other expenses such as sales, administrative, and financial must be deducted. (http://www.investopedia.com/)

Cost of Goods Sold (COGS) - **Cost of goods sold** (**COGS**) are the direct costs attributable to the production of the **goods sold** by a company. This amount includes the **cost** of the materials used in creating the good along with the direct labor costs used to produce the good. (http://www.investopedia.com/)

Cost and Time of Customer Acquisition



From initial marketing contact to closed sale
1 – 5%

Think!

- **Cost of acquiring a customer** ↓
- **The time to acquire a customer** ↓
- **Cost of integration by the customer** ↓
- **Follow-on service sales** ↑
- **Follow-on product sales** ↑
- **Total life-time value of a customer** ↑