

MEMORANDUM

From: Mark Gerhardt

To: Sarah Hughes. COO LegacyCo

Subject: NewCo request for Growth Funds

During this period you will receive a request from NewCo for Growth Funding. The amount is almost certain to be substantial. It will come in the form of a budgeting tool that will set out many of the underlying assumptions.

The Board and I have taken the decision that the funds transferred must be paid in one shot with you having the right to refuse any top-up request. This mimics the real market and puts discipline into the process. By having their growth funds banked as it were, NewCo is on an operational footing equivalent to that of an independent entrepreneur.

Additionally, to preserve staff career paths any funding of employees in any function will be on a sharing arrangement. The employees will work full time (mostly) for NewCo and if discarded by NewCo will return to LegacyCo. Their careers remain currently in LegacyCo.

GROWTH FUNDING TOOL

The core problem facing NewCo is estimating demand. Consulting reports have been made to the document you received in Period 1 and will be shared with you. However, in a completely new market the actual demand and the pattern of its emergence are both unknowns. Additionally, the level of competition and the consequent stimulation of the market from the extra 'noise' can be guessed at (4 competitors) but not known.

The tool asks NewCo to estimate sales by niche in both Periods 4 and 5. This two period horizon should be sufficient to take them to positive cash generation or we should be thinking of exiting. It also forces NewCo to decide on a market entry strategy. Whether one, two, or all three market niches. There are arguments for and against each strategy. **There are contained in the consultant report.**

The tool also forces NewCo to think in terms of customers not revenue. This opens their minds to customers as sources of value not just this specific product. NewCo is expected to specify the total number of customers by niche and the share of those customers they expect to land. Given that the average expected sale is known, the tool translates the customers into revenue. A standard cost of sales estimate is used calculate gross margin.

Under **People and Associated** costs NewCo will estimate the numbers of people they will need dedicated to this operation. NewCo will pay for the people out of the growth funds you provide, but the people will be physically located in LegacyCo facilities.

Under **Discretionary Expenditure** NewCo will estimate the amounts to be spent on advertising, social media and product development.

On the final page, there will be a summary of the total growth funds requested.

As was done in the **Start-up Funding Request**, you may negotiate the funding assumptions and refuse to provide the funds. But, you will need to justify your refusals given your role as banker.

Any contended issues will be resolved by me and my decisions will be binding.

MEMORANDUM

From: VP Strategy

To: Henry Morgan CEO NewCo

Subject: B2B AR Market

As you requested, I had a team research the likely structure of the B2B AR market and develop an assessment of the possible market size. I would caution you that the market size number is heavily based on guesswork at this point. Clearly, our estimates will firm-up as we get more experience of the market.

MARKET STRUCTURE

- The market is divided into three niches: Education, Government and Entertainment
- The estimated final total number of customers in each niche by the time it is mature is
 - **TO BE TUNED:**
 - **TO BE TUNED:**
 - **TO BE TUNED:** percent of total can be calculated

CUSTOMERS

- The customers fall into four categories with different characteristics: These groups emerge as the offering proceeds through the secular growth curve.
 - **Early Pragmatists (approx.15% of market):** first adopters of technology in the secular growth phase they seek to adapt technology to their specific needs. They are influenced by the reputation of the co-developer visionary, but want the offering adapted to their very specific needs
 - **Late Pragmatists (approx. 35% of market):** less interested in what the technology can do and more interested in the business returns. These customers want the offering delivered as a package that requires minimal adaptation to their needs
 - **Conservatives (approx.35% of market):** show little interest in the technology and seek an offering that has been productized such that it is extremely easy to install. After the technology excitement of the prior two groups it is easy to ignore this group by they are a significant slice of the market. They can be highly profitable
 - **Laggards (approx. 15% of market):** the final group that has no tech interest and just wants the issue to go away and to cost little or nothing in dollars and time. As most tech costs are amortized at this point this group can be highly profitable. Laggards assume that if others have bought something it is ok to buy. There is no need to focus on Laggards they will buy if they think you are dominant.

REVENUE BY NICHE

- The estimated revenue per customer to NewCo per niche per period from AR systems is:
 - Education: \$187,500
 - Government: \$250,000
 - Entertainment: \$275,000

MARKET LEGITIMACY

Legitimacy is the term used to describe how the market sees you as a serious player. Your level of perceived legitimacy strengthens your market position in the battle for customers..

- In the early rounds your legitimacy was tied to the reputation of the visionaries you worked with. . In case you did not note them at the time they are:

VISIONARY	Entry Legit in period 4 or 5 POINTS
VRKidEd	100
AdEdVR	75
GovVR	100
MilitaryVR	75
VRGames	100
VR Cinema	75

- That legitimacy carries over into sales to the Early Pragmatists. But not all of it will carry over Early pragmatists are very concerned with their own business. They will not believe that any visionary is just like them.
- In the rest of the curve, base legitimacy is tied to market success; the more customers you land and retain the higher your legitimacy.
- This base legitimacy number can be modified by the partnerships you form and the outside resources you work with. These bodies bring their own legitimacy, which amplifies yours.
- Finally, you can amplify your legitimacy by taking strategic initiatives.

THE BATTLE FOR SHARE

In addition to legitimacy, your relative strength versus competitors in any one niche depends on:

- Picking the right level of headcount and discretionary expenditure to make in each function

- Maximizing your functional competence
- The degree to which you focus your efforts. The more niches you focus on the more spread out are your resources lowering the chances of winning share
- The choices made by your competitors.

HALO EFFECT

A halo effect occurs when a purchase of one offering influences buyers of another offering.

- Success in selling into the education market influences buyers in the government niche
- Success in selling to government influences buyers in the entertainment business
- Success in selling into the entertainment will influence buyers in the education market

ENTRY STRATEGY

There are at least two approaches to market entry in a new market

- **Charge in and try to serve all niches at once.** This assumes that we have enough resources to enter all three niches with their different offering needs and buyer behaviour at the same time. The argument assumes there is sufficient overlap in the niches that sheer weight of effort will give us share in each niche. The risk is that we diffuse our efforts and lose focus so that we fail to get dominance anywhere. Additionally, in the early periods no-one really knows the offering and so it is difficult to argue that a 'halo' exists.
- **The 'bowling ball' approach.** This approach proposes that we enter one niche first and concentrate our resources on maximizing our market share in that niche. We would then carry that share with us into a related niche that accepts our customers as evidence of product suitability. The image is knocking over a head pin then using that to knock over the others.

Regards