

ENTREPRENEURSHIP

for Computer Science and

Engineering

Lecture 6:

Cost of Customer Acquisition (CoCA)

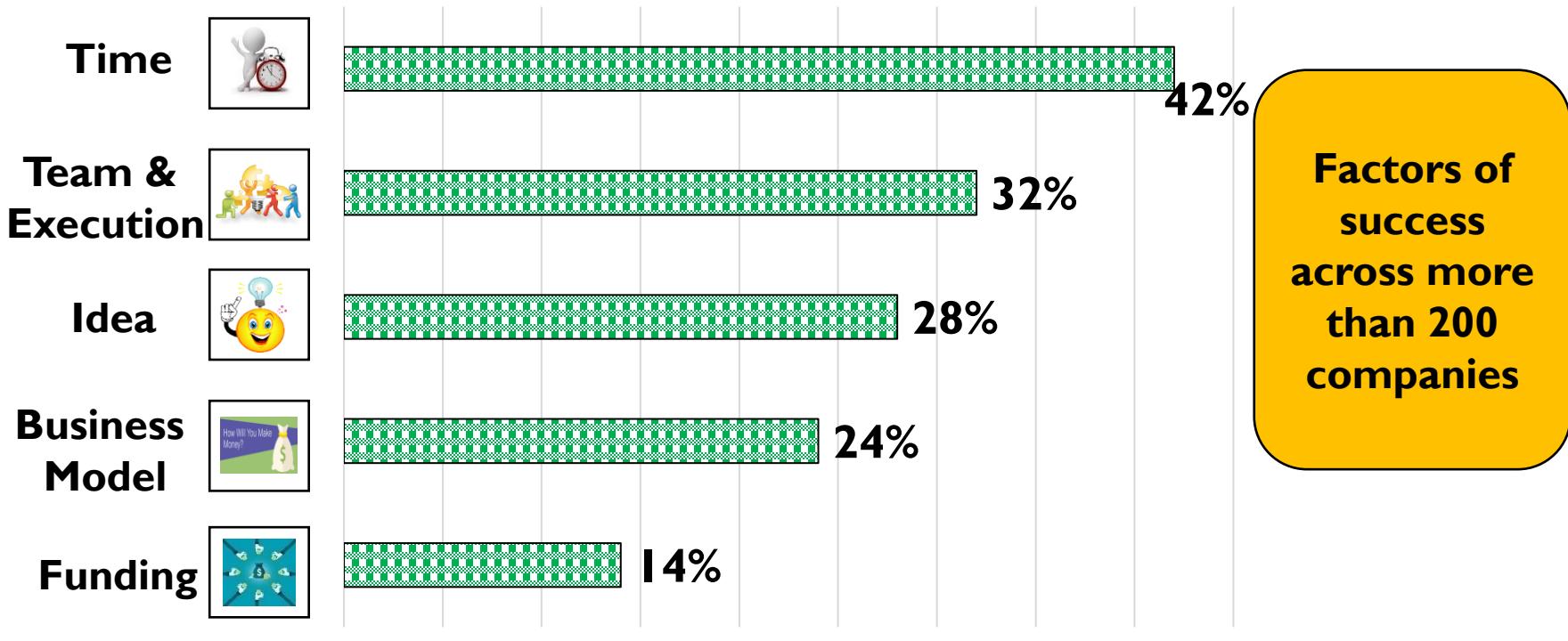
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Outline

- **Last Session:**
 - Calculate the Lifetime Value (LTV) of an Acquired Customer
- **This lecture**
 - Calculate the Cost of Customer Acquisition (CoCA)
- **Announcements:**
 - Course website: <https://www.m-zakeri.ir/Entrep/>
 - My research lab: <https://www.m-zakeri.ir/lab>
 - Milestone 3 of the project
 - Book template:
 - <https://github.com/m-zakeri/Entrep/tree/main/docs/assignments/book>
 - Tutorial making

Recap: What makes startups succeed?

- Factors of success



[Based on a study by IdeaLab]

<https://www.idealab.com/>

Cost of Customer Acquisition (COCA)

- Entrepreneurs consistently underestimate the real costs of customer acquisition.



Cost of Customer Acquisition (COCA)



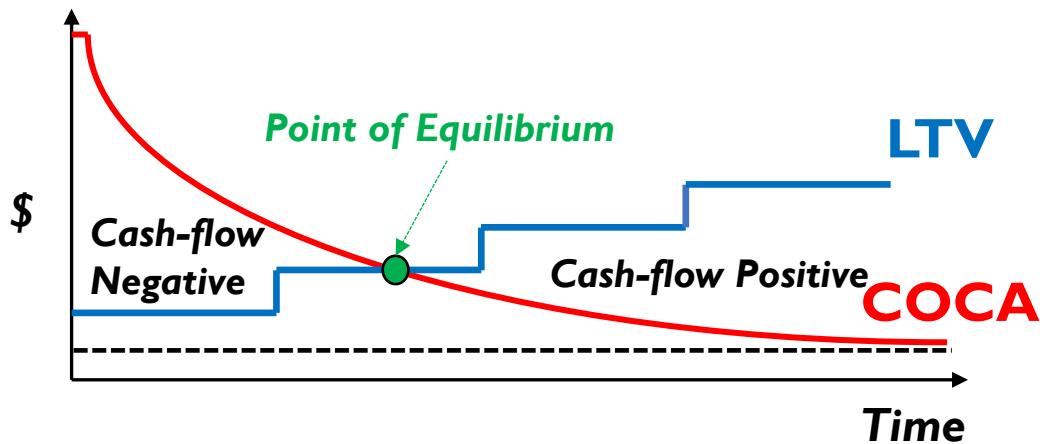
Optimism is good, but be careful not to blind you from the real cost of customer acquisition. It is essential that you do realistic calculations and then make appropriate adjustments over time.

Cost of Customer Acquisition (COCA)

- How much does it cost you to **bring a new customer to your product?**
 - In other words, how much is your COCA?
- In calculating your COCA, you must quantify *all* the sales and marketing costs involved in acquiring a *single average* customer in steady state
 - Examples of sales and marking costs include salesmen salaries, admin support, travel, entertainment, trade shows, phones, Internet, website developments, computers, etc.,
 - This necessitates that you understand your sales process very well!
 - Production, R & D, finance and administrations, and any other overhead costs are not included

COCA vs. LTV

- For almost all new ventures, COCA will start very high and decrease over time (opposite to LTV)



How to Calculate COCA?

- To calculate COCA, you need three metrics:
 1. Total Marketing and Sales Expenses over Time → **TMSE(t)**
 2. Install Base Support Expense over Time → **IBSE(t)**
 - This is the cost to retain existing customers
 3. New Customers over Time → **NC(t)**
- $\text{COCA} = (\text{TMSE}(t) - \text{IBSE}(t)) / \text{NC}(t)$
- COCA is typically calculated over 3 consecutive time periods, namely, *short-term* (e.g., 1st year of sales), *medium-term* (e.g., 2nd and 3rd years of sales), and *long-term* (e.g., 4th and 5th years of sales) periods
 - Depending on your venture, these time periods may be different!

Example: Associated Gas Energy

- Oil drilling typically produces “associated gas” as well, which is costly to deal with and problematic for the environment
- Assume a new venture, namely, **Associated Gas Energy**, with a GTL (Gas To Liquid) technology to convert “associated gas” into crude oil at a cost of \$70 to a *conservative* customer
- The customer can be convinced to buy using old-fashioned *direct sales methods*, especially at the beginning

Example: Associated Gas Energy

- **Year I Plan:**

- Hire an experienced sales person (say, full package at \$175K/year)
- Hire a tech sales support person (say, full package at \$125K/year)
- Hire a consultant to help break through the initial customer inertia and to get all regulatory issues taken care of (say, full package at \$150K/year)
- Spend on travel (say, \$24K), develop ad material (say, \$15K), conduct a trade show (say, \$30K), and develop a website (say, \$10K)
- Expected number of customers is 1

Example: Associated Gas Energy

- **Years 2 and 3 Plans:**

- “Fire” the consultant since all regulatory issues will be resolved by then, let alone that the hardest sale (i.e., the first sale) will be done
- Hire one extra salesperson and another tech support person every year to increase sales
- Increase spending on travel, ad material, trade shows, and website maintenance
- Expected numbers of customers are 3 & 7 in years 2 & 3, respectively

We will assume three time periods over only 3 years

Example: Associated Gas Energy

- COCA Calculation:

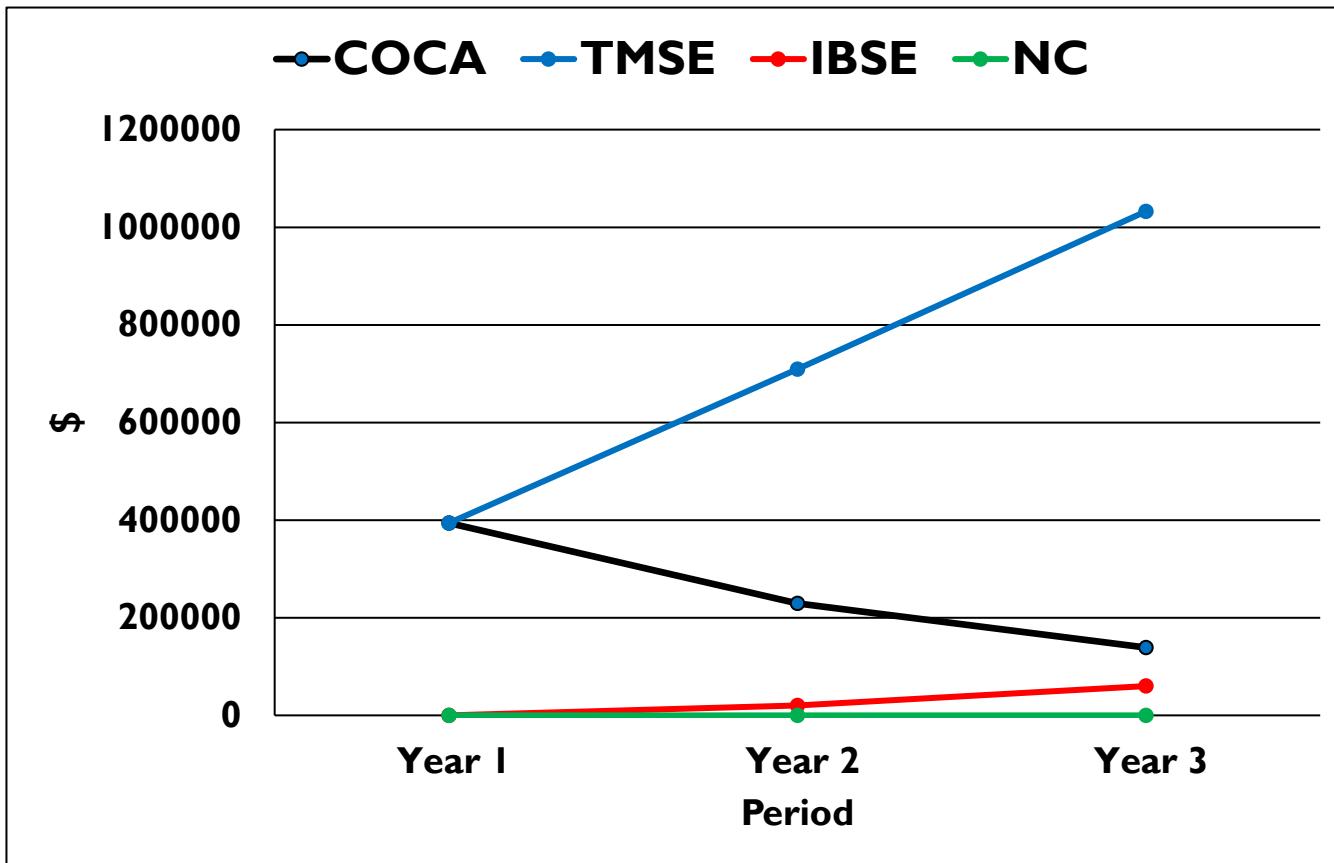
	Year 1	Year 2	Year 3
Salespeople Salaries	$\$175K \times 1 = \$175K$	$\$175K \times 2 = \$350K$	$\$175K \times 3 = \$525K$
Tech Support People Salaries	$\$125 \times 1 = \$125K$	$\$125 \times 2 = \$250K$	$\$125 \times 3 = \$375K$
Travel	\$24,000	\$40,000	\$52,500
Ad Material	\$15,000	\$24,000	\$30,000
Events	\$30,000	\$35,000	\$40,000
Website Cost	\$10,000	\$10,000	\$10,000
Consultant	\$150,000	\$0	\$0
TMSE	TMSE(1) = \$394,000	TMSE(2) = \$709,000	TMSE(3) \$1,032,500

Example: Associated Gas Energy

- COCA Calculation:

	Year 1	Year 2	Year 3
TMSE	TMSE(1) = \$394,000	TMSE(2) = \$709,000	TMSE(3) \$1,032,500
NC	NC(1) = 1	NC(2) = 3	NC(3) = 7
IBSE	IBSE(1) = \$0	IBSE(2) = \$20,000	IBSE(3) = \$60,000
COCA	COCA(1) = \$394K	COCA(2) = $(\$709K - \$20K)/3$ = \$229.666K	COCA(3) = $(\$1,032,500 - \$60K)/7$ = \$138.928K

Example: Associated Gas Energy



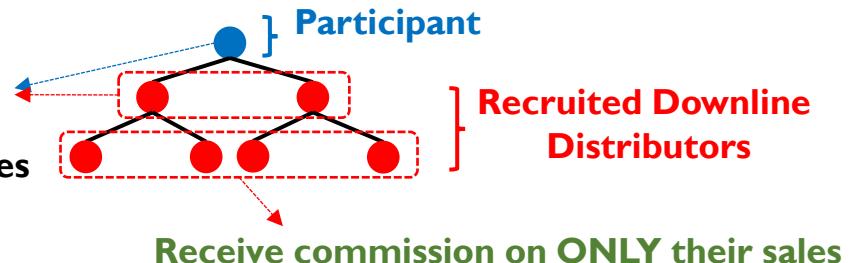
How To Reduce COCA?

I. While very powerful, use direct sales judiciously as it is very expensive

- Hiring a team to do direct sales may be necessary to start, but it is expensive
- Consider investing in *technological enablers* (e.g., telemarketing, effective web presence, social media, etc.,)
- Automate as much as possible via creating *incentive schemes* for your users to recruit others (e.g., Groupon & Uber)
- **Multi-Level Marketing (MLM)**, whereby a company makes revenue from *non-salaried workforce* (called *participants*), who sell its products and earn via a pyramid-shaped *commission system* is controversial (e.g., Avon)

Two revenue streams:

- 1) Commissions on their sales
- 2) Commission on their downline distributors' sales



How To Reduce COCA?

2. Improve *conversion rate* in sales

- Not every desired deal is closed, although (huge) cost is usually associated with every chased deal
- Increasing your rate of closing deals (e.g., improving your conversion rate) compensates for costs and opens up the funnel for more deals to get through
- One way to achieve this is to decrease the cost and enhance the quality of *leads*

3. Choose your business model with COCA in mind

- Your business model might make it easier to sell your product to customers; hence, decreasing the *sales cycle length*

How To Reduce COCA?

4. Drive positive word-of-mouth

- This can improve your company's stature and let you easily cross the chasm towards the mainstream market
- Focus on your beachhead market and employ the *viral engine of growth* (more on this next week)
- One way to measure results is to use the *Net Promoter Score* or *NPS*
 - How likely is it that you would recommend a product to a friend or colleague?
 - Respondents can be categorized into *three* groups:
 - I) **Promoters** (score 9-10) are loyal enthusiasts who will keep buying and refer others, fueling growth

How To Reduce COCA?

4. Drive positive word-of-mouth

- This can improve your company's stature and let you easily cross the chasm towards the mainstream market
- Focus on your beachhead market and employ the *viral engine of growth* (more on this next week)
- One way to measure results is to use the **Net Promoter Score** or **NPS**
 - How likely is it that you would recommend a product to a friend or colleague?
 - Respondents can be categorized into *three* groups:
 - 2) **Passives** (score 7-8) are satisfied but unenthusiastic customers who are vulnerable to competitive offerings

How To Reduce COCA?

4. Drive positive word-of-mouth

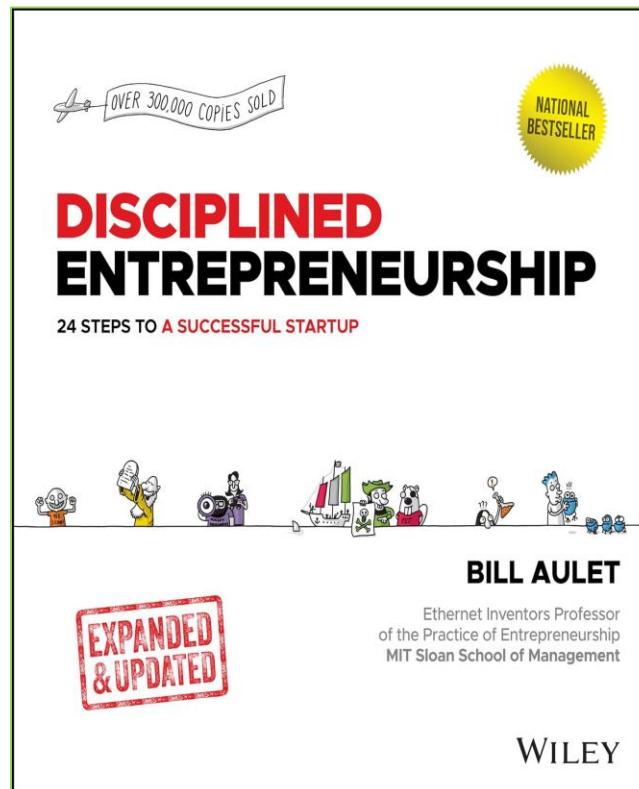
- This can improve your company's stature and let you easily cross the chasm towards the mainstream market
- Focus on your beachhead market and employ the *viral engine of growth* (more on this next week)
- One way to measure results is to use the **Net Promoter Score or NPS**
 - How likely is it that you would recommend a product to a friend or colleague?
 - Respondents can be categorized into *three* groups:
 - 3) **Detractors** (score 0-6) are unhappy customers who can damage your brand and impede growth through negative word-of-mouth
 - **NPS = % of Promoters - % of Detractors**

Summary

- LTV and COCA allow you to determine whether the financials of your business will work.
- They highlight the importance of keeping an eye on key factors to make your business profitable.
- They provide simple scoreboard than the three core financial statements (*which we will cover later in the semester*).
- **Recommendation:** Do not let your optimism blind you from doing the right calculations of and using LTV and COCA.

Reading

- Read **Step 19** of the “Disciplined Entrepreneurship” book
 - 2024 by [Bill Aulet](#)



Next Class

- Financial-Intelligence