HOW TO CALCULATE A BUSINESS CASE

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Business Case

There is no need to budget for an extensive business case or even establish a financial planning system at this early stage of your project. Nonetheless, we recommend that you are aware of some fundamental figures. Do not base these figures on market assumptions – draw directly from your insights from the previous customer tests.

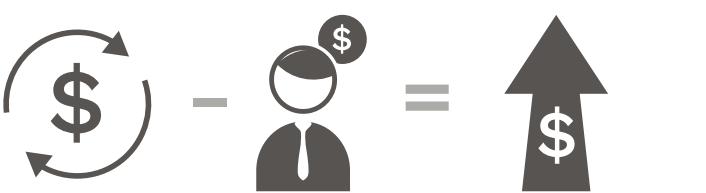
The following section explains your most important key figures: the customer acquisition costs (CAC) and the lifetime value (LTV) of your customer.

Customer acquisition costs (CAC)
To determine whether you can establish a profitable business, you need to know the cost of acquiring a new customer. The examples on the following pages will help you determine this value for your own project.

Lifetime value (LTV)
In addition to your customer acquisition expenses, you should be interested in one question in particular: how much do you earn from each acquired customer?
By comparing the two values, you can determine whether you have found a scalable business model and whether you get some profit out of it in the end.

Rules of thumb
Recovery of your CAC within <12 months
If you cannot recover your acquisition costs within a year, you are using too much capital to scale your business.

3x CAC < LTV
Your LTV should be at least three times your CAC in order for your business to be profitable.



B2C Business Model

If you are selling a product or service directly to consumers, you should base your calculations on this example. Companies that follow a B2C business model include McDonald‘s, Walmart and Amazon.

Sample calculation
You wish to sell your product directly to consumers via your website. To test your target customers‘ willingness to pay, you have already run a smoke test (landing page and Google AdWords / Facebook Ads).

- Cost for AdWords / Facebook Ads campaign (=**COSTS**): $400
- Number of obtained email addresses (=**LEADS**): 40
- % of interviewed leads who want to buy your product (=**SALES/LEADS**): 20%
- Anticipated profit (revenue minus cost) per month* and customer (=**PROFIT**): $20
- Anticipated % of customers opting out per month* (=**CHURN RATE**): 40%

*Depending on your business model, it may be sensible to calculate this on an annual basis.

CAC
In order to determine your cost per acquisition, you need to divide your acquisition cost by the number of sales you achieve. For the above example, the calculation looks as follows:

CAC = COSTS / SALES = **COSTS** / (**LEADS** x **SALES/LEADS**) = $400 / (40 x 0.2) = $50

LTV
In order to determine your profits per customer, you need to divide your average profit per customer and month (or year) by the anticipated percentage of lost customers for the same period of time. For the above example, the calculation looks as follows:

LTV = **PROFIT** / **CHURN RATE** = $20 / 0.4 = $50

In this example, the CAC is already recovered after 3 months (<1 year – PROFIT vs. CAC = $20/month vs. $50), but the LTV is identical to the CAC. This raises questions about profitability. Something must change: the CAC needs to be lowered, the PROFIT raised or the CHURN RATE decreased. It is important to explore and investigate such questions.

B2B Business Model

Unlike in the B2C model, a B2B product is sold to other companies. This tends to involve products with a higher sales value that are sold by traditional sales staff. Of course, this influences your calculations. Companies with a B2B business model include SAP, IBM and Salesforce.

Sample calculation
You want to sell your new business software to large-scale customers via your sales staff. As a smoke test, you have contacted a few companies, met with their respective representatives and asked them to sign an LOI (letter of intent).

- Monthly salary* (incl. social-security contributions) for one sales employee (=**SALARY**): $10‘000
- Number of sales (in this case, LOIs) per sales employee per month* (=**SALES**): 4
- Anticipated profit (revenue minus cost) per month* and customer (=**PROFIT**): $4‘000
- Anticipated % of customers opting out per month* (=**CHURN RATE**): 40%

* Depending on your business model, it may be sensible to calculate this on an annual basis.

CAC
In order to determine your cost per acquisition, you needto divide your acquisition cost by the number of sales you achieve. For the above example, the calculation looks as follows:

CAC = **SALARY** / **SALES** = $10‘000.– / 4 = $2‘500.–

LTV
In order to determine your profits per customer, you need to divide your average profit per customer and month (or year) by the anticipated percentage of lost customers for the same period of time. For the above example, the calculation looks as follows:

LTV = **PROFIT** / **CHURN RATE** = $4‘000.– / 0.4 = $10‘000.–

In this example, the CAC is already recovered in the first month (<1 year – PROFIT vs. CAC = $4‘000/month vs. $2‘500) and LTV is four times the CAC. This looks like a scalable, promising B2B business case. To prove that your business model is based on solid, conservative judgements, you can further hone your calculations by taking other costs into account besides salaries.

B2B2C Business Model

Today, a large number of combined business models exist in addition to the traditional B2C and B2B varieties. You may, for instance, sell your product to corporate customers while simultaneously advertising to consumers in order to boost the B2C sales of your corporate customers. Companies with a B2B2C business model include online platforms such as booking.com and amazon.com.

To quantify this type of business model, you should carry out two smoke tests: one B2C online campaign and B2B negotiations (as described in the B2C and B2B examples).

Now, you can calculate the CAC and LTV of your B2C and B2B customers independently of each other (see the B2C and B2B examples) and determine whether both sides of your business are scalable.

If one customer side is scalable and the other is not, you need to determine whether the profits of the scalable side offset the losses on the non-scalable side, or whether you need to adapt your business model.