



Unit 3

Developing a Product Idea

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Develop a product idea
- ✓ Identify your target market and customers
- ✓ Develop your value proposition

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Building On Your Business Idea

Developing Your Product Idea

Getting Started

Once you have a business idea in place, it's time to put some serious thought into the product or service that you will be offering

The **MVP** is your entry-level product (although other entry-level products may be developed later). It can be developed quickly, with minimum time and resources, and sold quickly. The **core product** will embody what your business is all about. Once you have these two elements developed and tested, you can start thinking about new product lines.

Problem Statement

The most important part of each product is identifying what problem it solves for the customer. Does it

- Create a fast, personalized coffee experience at home?
- Make bedtime for children under five easier and faster?
- Help working adults between 30 and 50 maintain a healthy lifestyle through diet and exercise?
- Create a safer home environment for seniors?

Outlining your product's purpose as a solution to a problem will help you evaluate whether or not you're meeting your goals, particularly when identifying the target market and testing the product.

Functional and Non-Functional Requirements

It's also important to describe what the product will actually do. These requirements can be broken down into functional and non-functional requirements. **Functional requirements** describe characteristics that solve particular problems for users. **Non-functional requirements** describe the background operation of the product or service.

Requirements for a coffee maker might look like this:

Functional	Non-Functional
<ul style="list-style-type: none"> Starts up in eight seconds 	<ul style="list-style-type: none"> Supports 120 and 240 volt plugs
<ul style="list-style-type: none"> Makes individual cups of coffee in 14 seconds 	<ul style="list-style-type: none"> Heats water to 212°F
<ul style="list-style-type: none"> Sanitizes itself after each brewing cycle 	<ul style="list-style-type: none"> Made out of carbon alloy

Features and Benefits

Next, let's look at features and benefits. A feature describes what a product does; a benefit describes the emotional impact of the product. Let's look at some features and benefits of our coffee maker example.

Features	Benefits
<ul style="list-style-type: none"> Makes individual cups of coffee 	<ul style="list-style-type: none"> Create a personalized coffee experience every time
<ul style="list-style-type: none"> Starts up in eight seconds 	<ul style="list-style-type: none"> Start your day right: by relaxing and enjoying a cup of coffee
<ul style="list-style-type: none"> Keeps itself clean with self-sanitizing mode 	<ul style="list-style-type: none"> Let your coffee maker do the work for you
<ul style="list-style-type: none"> 256 gluten-free, organic flavors currently available 	<ul style="list-style-type: none"> Feel good about your coffee choices

User Stories

The final element in developing your product idea is user stories. This allows you to outline possible scenarios where users will use the product. User stories can help you clarify the product vision; identify features, benefits, and functional requirements; and recognize possible issues.

The basic formula for a user story is, "As a [user role], I want to [desired outcome] because [reason]." For example, Tom is a daily coffee drinker who wants to be able to make a good cup of coffee at home easily and cheaply.

If we dig deeper, we'll see that Tom is a single dad with three children. A good cup of coffee is a necessity for him in the morning! However, his local café is pretty expensive. If he makes coffee at home, filling the coffee maker, grinding the beans, finding a filter, and setting up his coffee machine can be a real challenge while he's trying to get his children ready. A one-touch coffee machine, with pre-filled, top-quality coffee pods, would make things a lot easier for him.

Identifying Your Target Market and Customers

Three Key Questions

Your next step is identifying who your target market and ideal customer are. This will help you narrow down your business' focus and ensure you are putting your efforts in the right place. The goal of this stage is to help you identify three things:

- Who are my customers?
- Where are they located?
- How do they think and behave?

Step One: Theories

You should have some idea of who your customers will be based on your groundwork so far. (If not, it might be a good idea to return to that phase and do more outlining and analysis of your idea.) So, start by writing out your assumptions and theories:

- What is the basic product concept?
- Who will be my customers?
- What problem will the product help them solve? (Your problem statement can be used here.)
- What geographical area will we be targeting?
- What demographic will we be targeting? (Think beyond age, gender, and ethnicity. Consider value sets, passions, and skills.)
- Who will our competition be?
- What type of market will we be operating in: an existing market, a new market, or a niche market?

Get as much help as you can with this stage. Involve people who will be part of your business, experts in your industry, your mentor, and any other stakeholders.

Step Two: Testing

Next, create a list of at least 50 potential customers. With these people in mind, prepare your product test. Here are some ideas for product testing:

- A presentation of the proposed product or service and how it will solve their problems
- A hands-on demonstration of a prototype
- A preview of a television episode in front of a focus group

Be sure to have specific questions for participants to answer after the test, such as:

- What was your favorite thing about the product/service?
- What was your least favorite thing about the product/service?
- Here are three approaches we could take for this product/service. Please tell me what you think about each of them.
- What problem would this product or service help you solve?
- How would you use this product?
- Who would you recommend this product to?

You will also want to prepare a customer insight survey, with questions like:

- How much of your typical day is spent on...?
- How much money do you spend on...?
- What processes do you have for...?
- What is your biggest problem with...?

Keep this survey short and to the point to ensure maximum participation.

Now, ask your potential customers to participate in the product test and insight survey. Be very clear that this is not a sales pitch; you're looking for their feedback so that you can help them solve a particular problem. Be open-minded during this stage. Encourage criticism, what-ifs, and new ideas. You will probably hear new information that you had not yet considered. It can be hard to incorporate that into your vision, but it is essential for your business' success.

Remember what Sam Walton (founder of Wal-Mart) once said: "There is only one boss: the customer. And he can fire everybody in the company from the chairman on down, simply by spending his money somewhere else."

Step Three: Take It All In

After the product test and customer insight surveys have been completed, it's time to evaluate what you have learned and see if your theories were right or wrong. Be open-minded and objective when evaluating the data.

In most cases, you will find that you were right about some things and wrong about others. This means that you will want to adjust your theories, tweak your product test and insight surveys, and conduct another round of testing. (The amount of re-testing and re-evaluation required will depend on the complexity of your business idea.) In the end, you will have a solid description of what you will be selling, who you will be selling it to, where those people are, and what their mindset is.

Developing Your Value Proposition

Now that you have a solid business idea in mind and you know who you will be marketing it to, it's time to outline your business' value proposition. Your value proposition tells customers why they should buy from you by describing:

- Your product or service's features and benefits
- The value of the product or service (including its experience)
- What it will cost (in generic terms)
- Why it is unique
- Who the customer is
- How it will help the customer

Ask yourself: "What are we promising our customers? Why is it valuable to them?"

Think back to our QuikBrew example. Develop a value proposition for it.

Creating Financial Projections

Choosing the Right Approach

The final piece of your business idea is the financial projections. You need to have a fairly solid idea of what your business is going to cost to run and how much revenue it's likely to generate. We recommend using a basic bottom-up method, where you generate estimates for each part of the business and then combine them to get the big picture.

Finding Data

As an entrepreneur starting a new business, you have a major disadvantage when forecasting revenue and expenses: you have no historical data to base your facts on. This means that you will have to obtain data for similar companies in your industry and geographic area. Your expertise, and the expertise of your team, will also be invaluable.

Part One: The Sales Process

The first part of financial projections is looking at your sales process. How long will it take for your company to see payment after someone becomes a potential customer? Typically, customers move through the following stages:



If you're a hot dog vendor with walk-in customers, then your sales process is quite short. If you're selling luxury vehicles, then your sales process could be quite long. To help you get an accurate picture of how long your sales process is, you can use this template. We have included some example activities for a small business selling custom bicycles.

Sales Stage	Activities in Our Process	Average Length of Stage
Lead	Customer visits our website and fills out contact form	0-48 hours after first website visit
Prospect	Customer service representative contacts customer, confirms information, and obtains additional details in order to provide a custom quote.	Within 24 hours of form being submitted
Qualified Lead	Customer service representative re-contacts customer to provide custom quote. Credit check is also performed.	Within 72 hours of last contact
Committed Lead	Customer signs agreement for custom bicycle.	0-72 hours of custom quote
Customer	Company ships bicycle.	Four weeks after agreement is signed

	Customer sends payment.	0-48 hours of shipping confirmation
Total Average Length of Sales Process		Four and a half to six weeks

You should also consider these factors when you are estimating the length of your sales process:

- What experience does the market have with this product? New products and technologies can take a while to catch on.
- What does the customer have to do in order to buy the product? Are credit terms, payment plans, proposals, tenders, or other lengthy processes required?
- Who will be involved in making the decision? For example, company employees may be allowed to purchase small amounts of office supplies, but will need approval for bigger items.
- How urgent is the purchase? A higher urgency level usually results in a shorter sales time.

Part Two: Sales Metrics

The next part of your financial projections is sales metrics. You will need to determine:

- How much money each product will sell for (separated into one-time and recurring revenue)
- If applicable, how many sales each salesperson can make (account for ramp-up time)
- If applicable, how many salespeople you will have
- Daily, weekly, monthly, and yearly sales estimates

So, let's say that you have these figures for your new bicycle company:

- You estimate that each product will sell for \$100.
- You will have five salespeople. For the first two months, you estimate that each salesperson will make five sales per working day. After that, their sales will double.
- 25 sales per day, times approximately 25 working days in the month, equals 625 sales per month for the first two months. This equals \$62,500 in revenue for months one and two.
- After that, if all factors stay the same, revenue will be \$125,000 per month.

Let's look at an e-commerce company:

- You estimate that each product will sell for \$100.
- You will not have salespeople; all sales will be done through your website.
- You estimate that five people will purchase from the website on launch week, with the number doubling each week after that until it plateaus at 1,000 customers purchasing each week.
- Since the first month is a four-week month, this means 75 sales and \$7,500 in revenue in the first month.

- The second month, which is also four weeks, will have 1200 sales and \$120,000 in revenue.

It can be very difficult to predict sales estimates. Always err on the conservative side. As well, be sure to allow for seasonal variances. As your business grows, you will be able to update and refine your forecasts with actual data.

Part Three: Expenses

The final piece of the financial projection puzzle is your expenses. Luckily, your major expenses should be fairly easy to estimate. Here is a list of things to consider.

One-Time Costs

- Lease deposits
- Assets
- Initial office setup (chairs, computers, desks, etc.)

General Overhead Costs

- Rent
- Heat, lights, and water
- Communication costs (landlines, cell phones, Internet, etc.)
- Office supplies

Staff Costs

- Salaries
- Commissions
- Benefits
- Owner payouts

Advertising and Marketing Costs

- Advertising expenses (break down into appropriate channels)
- Trade shows and conferences
- Client expenses

Product Costs

- Labor costs
- Material costs
- Packaging

Special Costs

- Licensing and registration fees
- Professional service fees (accountants, lawyers, etc.)
- Insurance
- Outsourcing fees
- Emergency fund

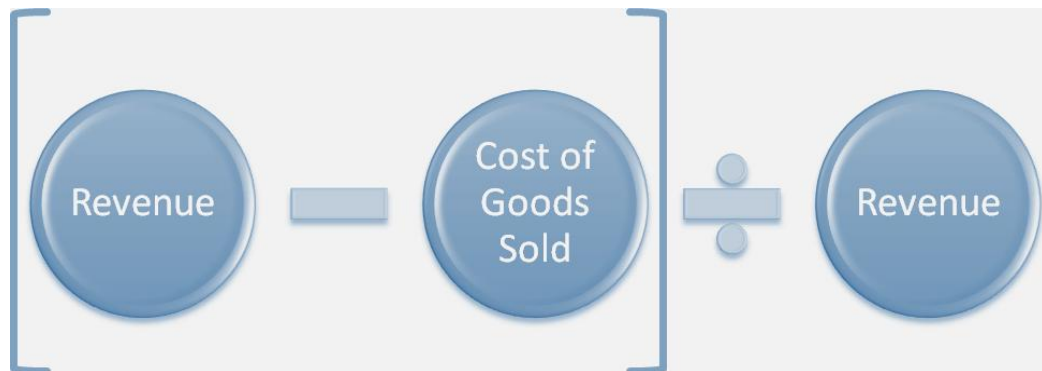
Double and triple-check your expense forecasting to ensure you've accounted for everything.

Part Four: Calculating Ratios

You now have all the information you need to calculate the key ratios that will tell you if your business, as you have forecasted it, will be a success.

Gross Profit Margin

Gross margin shows you what the company has made in profit. It is calculated with the following formula:



The results are then multiplied by 100 to obtain a percentage. For example, let's say that Acme Widgets made \$100,000 in revenue last year. It cost them \$50,000 to make the widgets. This means that their gross margin was 50%.

Operating (Net) Margin

The operating margin shows what proportion of the company's revenue will be left over after all expenses are paid. Its formula is simple:



The results are then multiplied by 100 to obtain a percentage.

Head Count per Client

The final ratio that you should calculate is how many staff you need to support each client. If you know that a team of 10 people (including sales, support, and manufacturing) can make 500 widgets, and that each client buys five widgets at a time, your head count per client is one person per ten clients. This ratio will help you plan operations and resources to match your company's growth.

Further Reading:

- ✓ *Brady, Steven M., Dennis C. Nagle, and Ralph R. Young. How to Save a Failing Project: Chaos to Control . Management Concepts, 2009.*
- ✓ *Lewis, James P. Project Planning, Scheduling, and Control (5th Edition). McGraw-Hill, 2010.*

