PRACTICE CASE STUDY GUIDE

Capital One®

TRY A PRACTICE CASE

Want to walk through a real world example of a case you might see during our interview process?

Background information

You are a manager at a marketing and publishing company that is looking to diversify.

You receive some information indicating magazine publishing might be interesting.

You are considering developing a new magazine, but are not sure how profitable it might be.

What are some of the issues you must consider when evaluating the magazine industry?

THINGS
TO CONSIDER

- Customer demographics and desire
- Competition (number of competitors, fragmentation, brand name)
- Alignment with existing business strengths
- Barriers to entry
- Broader economic cycle
- Business cycle stage
- Advertising effectiveness
- Opportunity cost
- Costs and supply chain structure
- Revenue sources

As we're considering opening our own magazine, let's look close at the specific economics of a typical business. What do you think are the components that contribute to profits for a magazine?

THINGS TO CONSIDER

Through some initial research you have been able to determine the following...

- You can charge £25 for an annual subscription of 50 issues.
- You can generate £1 in advertising revenue for each physical copy printed.
- Printing and distribution costs are £1 for each physical copy printed.
- Content development costs run £1 million per year.
- Let's ignore newsstand sales and other revenue sources for now.
- Let's ignore marketing expenses and other costs for now.

Which do you think are the largest profit drivers?

CALCULATIONS

LET’S FIGURE THIS OUT TOGETHER

Incremental subscription profits are...

- Subscription revenue per year = £25
- Advertising revenue per year = £50
- £1/issue x 50 issues
- Yearly production and distribution costs = £50
- Profit from one incremental subscription = £25
- £25 + £50 - £50

How many subscriptions would we need to sell in order to break even on this venture?

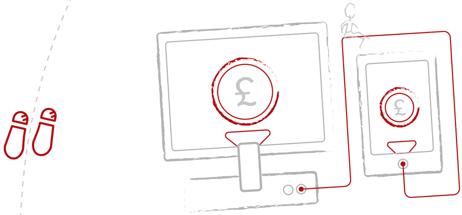
CALCULATIONS

LET’S FIGURE THIS OUT TOGETHER

How many subscriptions would we need to sell to break even?

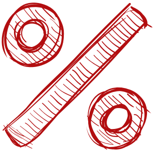
- Incremental profit = £25 per subscription
- Magazine content development = £1 million per year
- Break even = £1 million / £25 = 40,000 subscriptions

What else would you want to consider to determine whether this was a worthwhile venture?



LET'S FIGURE THIS OUT TOGETHER

Cost per subscriber calculation.



You company has expertise in direct mail solicitation so you decide to use that method to market your new magazine.

Each piece of mail costs £0.50

You are able to achieve a 2% response rate.

How much does it cost you to sign up a subscriber?

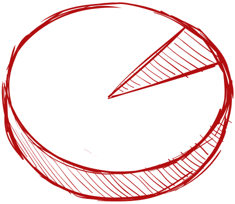
CALCULATIONS

LET'S FIGURE THIS OUT TOGETHER

What about marketing costs?

- Cost of mailing/response rate = cost to sign up to one subscriber
- £0.50 / 2% = £25 per subscriber
- Another way to calculate cost per subscriber:
- Assume you mail offer to 100 people
- Costs = £50 (£0.50 x 100 people)
- Responders = 2 (2% of 100)
- Cost per responder = £50/2 of £25

How will this affect you break even calculation?



CALCULATIONS

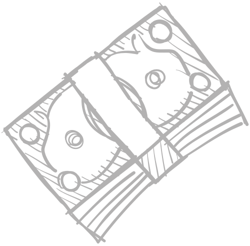
LET'S FIGURE THIS OUT TOGETHER

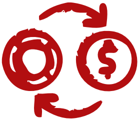
New break even calculation

- New incremental profit
  = £25 - £25 = 0

- Previous incremental profit – marketing costs = new incremental profit

OUCH! What are some ways we could improve profitability?





THINGS TO CONSIDER

Some possible considerations

- Raise subscription prices
- Raise advertising rates
- Reduce production costs
- Increase response rate
- Include lifetime subscription value (renews and multi-year subscriptions), not just single year
- Increase advertising volume

Renewals seem promising, as the cost to acquire may be lower than that for new customers.

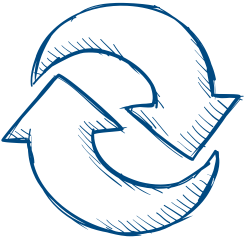
How might you encourage renewals?

THINGS
TO CONSIDER

Some possible options

- Price promotion
- Competitions
- Marketing
- Free gifts

Preliminary research shows probable outcomes of two possible options:



1. Do nothing: 50% of existing subscribers will renew each year
2. Offer a few second year subscription: 75% of existing subscribers will renew each year

Which is the best option?

LET'S FIGURE THIS OUT TOGETHER

Let's model the profits for each strategy

Option 1

- Assume 40,000 customers in year 1
- £25 net revenue per customer per year (excluding fixed costs)
- 50% renewal rate per year

CALCULATIONS

LET'S FIGURE THIS OUT TOGETHER

...so our overall net revenue for year 1 subscription is

40,000 * £25 (100% + 50% * 50% + ...)

– upfront marketing

...using $1 + a + a^2 + a^3 + ... = 1/(1-a)$,

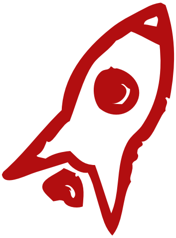
taking a = 50%,

we get a total of 40,000 * £25 * 2 - £1 million =

£1 million

What about Option 2?

LET'S FIGURE THIS OUT TOGETHER



Option 2

- Assume 40,000 customers in year 1
- No net revenue in year 2
- Assume a 75% renewal rate every year, including year 2
- Revenue resumes in year 3

Free year 2 subscription cost =
40,000 * £25 * 75% = £750k

CALCULATIONS

LET'S FIGURE THIS OUT TOGETHER

…so our overall net revenue for year 1 subscription is

40,000 * £25 * (100% + 75% + 75% * 75% + …)

- £750k – upfront marketing =

40,000 * £25 * 4 - £750k - £1 million =

£2.25 million

So which option would you go with?

Option 2 seems to be the obvious choice

What other information would you consider in making this decision?

Option 1 = £1 million vs **Option 2** = £2.25 million

Option 2 is the obvious choice

Are you sure?

WHICH IS THE BEST OPTION?

Not necessarily!

How would investors react to volatile revenues?

Can the £750k investment be better used in a different marketing campaign, perhaps attracting new customers?

Is profit next year as good as profit today?

What next steps would you recommend the team exploring a magazine business pursue?

Some tips

- Stay confident – stay cool
- Show enthusiasm – not frustration
- Be thorough – avoid mistakes
- Ask questions – don't be afraid

BUSINESS ANALYSTS