Multimedia Bookstore: The Evolution of a Concept

Peter Kelly
Helsinki University of Technology

An Experienced "Retail Investor's" Reaction

- not enough margins in retail
- major risk that you educate market for the benefit of larger players
- could not visualize how to achieve exit from the business - nothing of real value created for larger trade buyers & too small for a public offering
- product users (youth) are not the purchasers (adults) -- toddlers don't carry credit cards! (is retail the way to reach this market??)

3 months have passed....

- very little "real" capital spent but two individuals involved have not taken any salary!
- is there another way? can we develop a model that works?

what would you do next?

Do More Market Research!

- get on a plane to see what is being done in US
- found US market was "one year ahead of UK"
- no clear consensus on how to retail kid's software
- discovered a specialist software retailer, Kidsoft, which had raised $30 million in venture capital and had developed a unique approach to this market

Kidsoft

- use innovative blend of CD-Rom sampler disk and a paper catalogue
- in 12 months, disk distribution had risen from 25,000 to 1,25 million per year
- Compaq Computer agreed to bundle the software and was an early investor (concept credibility)
- CD was able to profile 100 titles which could be downloaded using encryption codes + had order fulfillment functions (ordering form)

Would the concept travel?

Management Team

Alastair Gregory (36) - Managing Director
A founder of Film Network Ltd, a cinema development and operating company which raised £2.5 million in VC and achieved turnover at time of his exit of £1.5 million/year. He has experience in direct mail, raising venture capital, and entertainment industry retailing.

Mark Anderson (36) - Product Development Director
A communications and information management specialist with the Royal Navy until 1993. Now consults in area of new technology integration.
Other Key Players Involved

Sir Ivor Cohen - Non Executive Chairman
He holds numerous non-executive directorships in major electronics companies. Senior management experience in publicly traded firms.

Ian Ritchie - Non Executive Director
A lawyer who specializes in intellectual property law particularly as relates to software.

The Mouse Club (December 1994)

• using McDonalds pull strategy target 3-11 year olds
• stock 100 of most popular CD-Rom titles
• print quarterly publication at £26.00 per year that would include a CD-Rom demonstration disk

how do you find customers?

Finding Customers

• bundle CD with hardware suppliers (time lag?)
• subscription (expect 27,500 subscribers by year 2)
• newsstand sales
• computer stores and toy shops (£9.95/issue)
• promotional spend of £50,000 at launch and £25,000/issue thereafter

How Much Is Needed?

• initial design & programming (one-off) £120,000
• market research/company set up £ 60,000
• set up costs for one disk edition £ 50,000
• production costs per disk (VC) 1.25

• budgeted financial performance
  Yr 1: sales = £1,100,000; loss after tax = (£100,000)
  Yr 2: sales = £1,600,000; profit after tax = £200,000

• need £500,000 EQUITY

How to test this business model?

How much was raised?

• principals had been working without salary since the inception of the business
• raised £64,000 from private individuals to develop one prototype of the CD-Rom demonstration disk
• small amount of money was also allocated to doing some basic market research

What Did We Learn?

Elements of the Plan Were Clearly Not Feasible....

• bundling involved long lead times (6-12 months)
• need to reduce purchase risk of consumers
• difficult finding target customers economically

Refine the Plan!
Rom Rats (1996)

- retained club concept (3-11 yr old target)
- disk updates provided 3 times per year (from 4)
- one time £14.95 up front free with minimum 2 CD purchase requirement (formerly £26.00 per year)
- need £275,000 equity and £180,000 loan facility
- need more refined market research

Raised £375,000 from private investors or business angels

What market research would you do now to test the business model?

Market Research

- bought targeted mailing lists
- advertised in newspapers and computer magazines
- distributed free disks to schools
- continued to monitor what was happening in the market with competitors
- altered the “formula” to see what happened

What Did Market Research Tell Us?

- formula was wrong - now £4.95 joining fee and one free title (£29.95 retail) provided that you purchase 3 more titles within a year
- average order size was £31.50 and each customer made 2.5 orders on average per year
- direct mail response rates were 0.2% and it cost £35 per thousand names or £17.50 per target name

The “Improved” Model

- cost of finding one target customer £17.50
- cost of processing new member £3.00
- cost of introductory offer £6.00
- cost of mailings per annum £5.50
- revenue: joining fee + p/p £7.00
- orders placed (net margin) £40.00
- how much is made off each customer each year? £15.00 per customer in first year

Postscript

- £432,000 has been invested in this venture to date
- Richard Cape joined team as Marketing Director
  He previously founded a firm called Books for Children which built up a direct mail database of 100,000 names
- need £1,100,000 equity & £800,000 debt in 8 months
- how many customers in data base? (approximately 2000)