Software Economics

Cost Structure
Cost Structures

Describes the costs for operating the business model.
Questions about costs

- What are the fundamental costs my business has?
- Is my business more cost-driven or value-driven?
- Are my costs mostly fixed or variable (moving with certain parameter)?
- What key resources make up a big block of my costs?
- What key activities make up a big chunk of my costs?

COSTS MATTER

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Cost vs. Value Driven

- Their value proposition is heavily connected to “low cost”
  - Maximum automation
  - Extensive Outsourcing (costly functions)
  - Efficiency all across the organization
- Price wars occur – the one with the lowest cost structure survives
- Examples – Ryan Air,
Value Driven

- Focus on value creation for customers so costs are not the focus (they can charge more).
  - Premium Value
  - Personalized Service
- If needed to increase profitability, it's not by cutting costs that can affect value perceived by the customers.
- Competition is not on price but value
- Examples: Luxury Hotels
Trade off ...
Types of Costs?

**Fixed Costs**

- Costs that are independent of volume (usually time related costs).
  - Rent
  - Salaries
  - Production facilities
  - Loan payments
Types of Costs?

**Variable Costs**
- Costs that change with volume.
  - The input cost of production (COGS)
  - Commissions
  - Cost per time unit used
Types of Costs?
Economies of Scale and Scope

Economies of Scale

Type of cost structure that causes the average cost of producing something to decrease as the volumes increase.

- Printing a book – First 100 copies cost 3,000€ but to print 1,000 copies cost 4,000€. Compare average cost per book.

- Do software products follow “Economies of Scale”?

- Why does this matter?
Economies of Scope

Factors that affect the cost of producing different but compatible products together as opposed to producing them separately (or multiple markets)

- Centralized functions (HR, Marketing etc.)
- Production of different but compatible products (using same resources)
  - Apple and Orange Juice
  - Coca Cola, McDonalds, Proctor & Gamble

- Do does Apple and Google use “Economies of Scope”?

- Why does this matter?
Exercise

Who are the most important costs in your selected company?

Which key resources are most expensive?

Which key activities are most expensive?

What is their cost structure in terms of Fixed vs. Variable and Scale vs. Scope?

About 20 min.