Software Economics

Cost Structure
Cost Structures

Describes the costs for operating the business model.
Cost Structures

- Focus on Value creation where cost is not the focus (they can charge more).
  - Premium Value
  - Personalized Service

- Their value proposition is heavily connected to “low cost”
  - Maximum automation
  - Extensive Outsourcing
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?

Units/Quantity Sold

Total Costs

Sales
Economies of Scale

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.

- Centralized functions (HR, Marketing etc.)
- Production of different but compatible products (using same resources)
  - Apple and Orange Juice
  - Toothpaste, toothbrush etc.

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

- 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.