

THE G-FREE APP

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ABSTRACT

It is important to understand and appreciate the mindset of financial investors when they assess all the different aspects of risk relative to investing in an entrepreneurial venture. This case takes one through that process as a group of senior management consultants review and discuss a business plan submitted by a group of undergraduate business students and the merits of this case to determine if they should invest.

LEARNING OUTCOMES

- Students will learn and understand how investors assess different elements of risk
- Students will appreciate what determines a well written business plan
- Students will develop analytical skills in assessing business opportunities
- Students will learn how to prepare effective written and oral presentations to investors

INTRODUCTION

At their weekly management meeting, the three co-founders and senior management executives, Joe Stasio, Jimmy Walker and Tom Mc Laughlin of C-Level Clone, a management consulting firm operating in Massachusetts, are reviewing one of many business plans and innovations from people seeking funding and management help with their ideas. The plan under review, The G-Free App, was submitted by a group of college students as part of a project they completed in Professor Stasio's course on business analysis and decision-making. In addition to teaching at a local college, Joe Stasio is an accomplished practitioner, having started over a dozen companies in 45 years in business. For thirty-five of those years, Joe has taught entrepreneurship courses in several colleges and universities in the Boston area.

"Gentlemen, have you had an opportunity to review the G Free business plan?" (**See exhibit 1**) asked Joe Stasio at their weekly staff meeting. Both Tom McLaughlin and Jimmy Walker said yes. All three are Co-founders and managing partner of C-levelclone.com (CLC) a management consulting firm, that until recently had specialized in turnaround situations for troubled businesses. Hence the name C-Levelclone designed to suggest how the partners would assume the role of the C level management (chief level) of a company until a new plan was in place and then relinquish those roles back to the rightful team to execute the plan. Often they would assist the company's team until they felt comfortable to leave them on their own. Now, for the past several months, C-levelclone began to work with entrepreneurs in start-up situations seeking funding and helping to growing their businesses. The G Free App business plan was the latest submission to be analyzed by the partners.

Joe Stasio teaches business management at a local university. As part of a course, teams of students are required to create an innovation, research it, write a comprehensive business plan and present it at the end of the semester. John is always searching through these plans for the ones to consider bringing to his partners for consideration. Over the past few years, C-Levelclone has invested in two student created projects: one is an interesting specialty item called the Slackback (See www.slackback.com) and the

other an innovative piece of hockey equipment designed to protect players from injuries and ease the discomfort of wearing this piece of equipment. Both projects have been progressing well. The G Free App is another possibility. From the onset, John liked the idea. As his students, Kimberly Martin, Louise McGillivray, Lauren Palazola and Alexander Zahlaway developed the concept and finished writing the plan, John asked if his partners could view their presentation with the chance that a deal might materialize after serious analysis and consideration from C-Levelclone. The students were enthusiastic about the opportunity and agreed.

“So, whadda think?” asked Joe. Jimmy replied first. “I like it. I really like it.” Tom chimed in, “Ya, me too. I especially like the way they developed the app concept.”

Everyone was impressed with their presentation and the quality of their plan.

THE G FREE APP

The G Free Mobile App is designed to enhance the lifestyle of people who suffer from celiac disease, are sensitive to gluten or who want to live a gluten-free lifestyle. It will allow for the choice of options for food products, restaurants and cosmetic products that are gluten free. It will have five different applications—a barcode scanner, a list of ingredients, a recipe sharing service, restaurants with gluten free meals and a cosmetic section identifying those brands that are gluten free.

“Yes, I like it too.” said Joe, “But I’m afraid it seems to be a bit too ambitious. The scope of that concept is very broad. Imagine how much programming would go into just the basic development of the app., accessing all that information, organizing it and then managing it day- in and day- out as people use the app to organizing their lives.” “Then there is the issue of accuracy. According to the research, there are about 3 million Americans alone that suffer from celiac disease, another 18 million people who have non-celiac gluten sensitivity. That is twenty-one million people potentially depending on the accuracy of this information.”

“I know,” says Jimmy, “that is a concern. But I like the idea of about 21 million more people still undiagnosed with about a half million of those with celiac disease. That essentially doubles the market size over the next 5 years.” “I think it’s a concern worth considering.” “We could be moving into the heart of a growing market. Consumers see gluten free products as part of a larger and stronger trend of healthy eating. Increasingly, more and more national and regional brands are adding gluten free products to their lines. It makes little difference to them about celiac disease or gluten sensitive. Right now I think the industry is in the growth stage. They grossed \$5.5 billion last year and it is expected to increase to \$7 billion in 3-5 years. Even the Girl Scouts have gluten free cookies and I’ve even seen gluten free greeting cards.”

“What about competition?” asked Tom? “How many other apps or web sites offer similar services?”

Competition

“Tom, I reviewed the competition on line when I was grading the paper to ensure accuracy of information and thoroughness of effort” replied John. “Here is what I found. The team did identify the two biggest and most popular web sites regarding gluten information, but there are about a dozen more that offer specialized information and services. For example, iEatOut Gluten & Allergen Free App for iphones and ipads allows you to select different allergens (diary, eggs, fish, among others, along with gluten, research ingredient lists from various sample ethnic and international restaurant menus to determine what selections might be suitable for you. One problem with this app is that it does not include actual menus with allergen information. You need to double –check with the restaurant to ensure the food you want can be prepared. It sells for \$4.99.”

“Another is Gluten Free Groceries App, which produces a popular version of its gluten free grocery guide. It contains more than 30,000 gluten free grocery store products. It covers products by brand names, such as Heinz, Coca-Cola, and Kraft and by store names like Walmart. You can search by either category and it costs \$17.99” Others apps like, CelliacFeed, Gluten Free Daily and iGlutenfree are variations of these, but are still numerous.”

“The only real difference I think is that this product adds is the cosmetic element” said Joe. “Although it does mention a barcode scanner and a recipe sharing service but does not develop either concept.” “I do like the competitive matrix the students did in the plan, replied Jimmy, “it covers many important factors that consumers would be interested in, and measures them rather well.” “I’m just not sure how accurate it is by leaving out some of the other competitors.” Tom continued, “The G-Free App plan identifies, as their sustainable competitive advantage, two factors; a comprehensive site that offers more information about all the categories than their competitors who specialize in only one and that they will be the only site that will offer information on cosmetics.” “Does that seem like a strong argument for their app?” “I believe there is another differentiator, says John, “this app will be compatible with both Apple and Google products. All the others are just made for Apple store.” “I wonder how much of an affect that might have on sales of their app?” “You’re right, said Jimmy, I checked and it is written in their plan.” “It is a very interesting situation, says Joe, according to Dave Smith at www.readwrite.com, Apple generates about \$5.1 million in revenue per day from their App stores while Google banks only \$1.1 million per day. But Android accounts for roughly 75% of all app downloads and Apple about 18%. Google has a larger installed base than does Apple; it has more products and properties than Apple, and is on more smartphones than Apple. Why the disparity in revenue? Apple has more apps, less malware, and more money for developers and advertisers than Android and Apple is preferred because it is significantly less fragmented.” “Yet, Android is catching up and is expected to pass Apple soon.” “There is no data on how many of the same apps are sold on both systems” said Joe, “so I’m not sure if there can be any advantage by taking this approach.” “I disagree, replies Tom, “I think it can be a distinct advantage. The market coverage alone will be advantageous.” “My understanding is that Google is the strongest brand internationally but Apple dominates the US market,” adds Jimmy. So, unless there is compelling evidence that our app will have appeal overseas, it might not be as advantageous as you think.” “It will probably cost more to develop the app to conform to each different standard for Apple and Android, and these costs will affect any pricing strategies under consideration.”

Pricing

“In their plan the students settled on a starting price of \$7.99 with an annual fee of \$0.99. They also indicate a \$2.00 promotion discount at special events as part of their communication strategy. However, they never explained how they arrived at that number.” said Jimmy. “The competition has prices ranging from a high of \$17.99 to a low of \$3.99 and no one has listed an annual fee other than G-Free,” offered Tom.

“Pricing is critical to an effective selling strategy,” said Joe. “It denotes the value of what is being offered. G-Free is designed as a premium product and its price should reflect it. Only Gluten Free Groceries is priced higher so at \$7.99, the starting price seems about right.” “I’m just not sure about the annual fee.” How can it be justified?” What is G-Free offering for that fee that other sites may be giving for no additional cost?”

“Another consideration is the fees charged by Apple and Google to sell apps at their stores. For example, Apple charges 30% of every sale which is \$2.40. Google does not have a sales charge but requires a fee of 30% when the app is uploaded by customers. I’m not sure how the different methods of collection might affect our revenue, but the absolute amount is the same. Of course, the app could be marketed and sold directly which would save that 30% commission.”

Tom added, "What about banner ads for the web site? It may not be able to happen immediately, but, at some point, that could certainly add some serious revenue to the mix. For example, I know there are many formulas for determining how to charge for banner ads on your web site. One such formula is $\$X$ per month per ad with X being the daily visitors count to your site divided by 10. So if the daily count was 1000 visitors, then the amount charged would be $\$100/\text{month}$. With this method it is not hard to imagine how a successful web site could not add substantial revenue with growth." Yes, said Jimmy, but there would be a cost associated with selling those ads. We have yet to calculate what that might be."

Advertising and Selling

"Speaking of selling, said Joe, what about their approach to advertising and selling of the app? In their plan, the students indicate that the primary market is people who suffer from celiac disease and the secondary market is people who are gluten sensitive or choose to live a gluten free lifestyle. They indicate a selling strategy of working with doctors whose patients suffer from these maladies. That sounds reasonable, but as a practical matter, is it doable? I know doctors, in general, are the most difficult of prospects to sell to. This might require a dedicated sales effort to make it happen."

"I'm not sure that is the right approach," added Tom. "Only 3 million people have actually been diagnosed with the disease. How can those doctors who specialize in these matters be identified? According to what I could discover, many of the best programs take a team approach to diagnosing and treating celiac disease. For example, a typical team would consist of a gastroenterologist, a GI pathologist, a GI radiologist, a food allergy specialist and a nutritionist. These doctors are involved in more than just treating celiac disease and to what extent would they be interested in supporting one of many resources dealing with this malady? Besides, the rest of the 21 million potential customers do not have the disease and would not seek medical assistance."

"The medical question aside, an absolute must would be to develop a comprehensive social media strategy, said Jimmy. The students indicated using all the usual tools, from Alpha to Omega. What might that look like? This is so beyond our expertise, we would need either the students or other experts to develop this part of a communication strategy."

"I noticed, in my review of their plan, that $\$1000/\text{month}$ has been identified for advertising expense, said Joe. They obviously recognize the need to promote the app to the market but fail to explain how they plan to spend those monies. It raises some interesting questions about how to do that. There is any number of methods to communicate with your potential customers." "I think they get a great deal of free publicity from both Apple and Google just by selling the app in their stores, replies Tom, But I really think the best way to spend that $\$1000$ is with pop-up ads on targeted web sites that provide information about celiac disease and gluten issues. The ads would entice people to download the app and continue to access more information that is of interest to the reader. We would be communicating to and directly influencing the very people we want." "I agree, says John, it makes perfect sense. So the challenge is to identify those web sites."

"I think a big concern for us deciding whether to fund the plan or not is the operations of G-Free and all the elements associated with the day to day running of the business, said John, For example, The students determined that it would cost $\$37,500$ to hire a developer to create the G-Free app. Let's assume that is about right. But we know information on the app will need to be updated on a regular basis. Will a developer need to do that or can another employee be responsible for that task? In addition, someone will have to be responsible to research the marketplace and determine what information should be used in those updates. It seems reasonable that the person researching information should be knowledgeable about celiac disease and gluten issues to make these determinations. I know, for example that one way to stay competitive with an app is to roll out updates on a regular basis. This allows your

users to continuously look for these updates and it keeps your app fresh and more appealing to new users. These tasks could require two people or just one. It makes a difference regarding expenses.”
“In the plan, the students indicate they would want to operate the business, replied Jimmy. I know one of them has celiac disease because that is how they decided to create this app. but I’m not sure they would be capable of managing the operation without some supervision. After all, they are barely 20 years old and are still in college. I don’t think it could be done on a part-time basis even with our managerial support.”

“I agree, said Joe, remember all the difficulties we are having with the team from Slackback. These kids have graduated and are now pursuing careers. They want to be involved but only on a part-time basis. This has put much pressure on us to oversee what they’re doing. They really do not understand, nor should they, the extent of market pressures and the need to operate with a sense of urgency. We are constantly micro-managing them because they continuously miss deadlines to which we previously agreed. We need to ensure that we do not create another working arrangement like that with the G-Free team. If we agree on a partnership deal, this issue must be foremost on the agenda.”

“Absolutely right and another thing, Tom continued, “Having a physical location like an office is not that important. Initially, we could operate in someone’s home until the business expanded to a point that necessitated office space to accommodate more personnel.”

“I’m not sure I agree, said John, I think an office lends some credibility to a company. It gives it some sense of legitimacy. You need room to invite business associates to meetings as part of growing a business. It could be a small space to start with perhaps some room to grow. If not, then a move might be in order to sustain any momentum achieved by company.”

“Getting back to personnel, how many people do we think it will take to run this operation effectively? says Jimmy. What will be their tasks and how much should they be paid? “

“In light of these questions, replied Joe, we should consider outsourcing as much of the tasks as possible. It will save us payroll taxes and addressing benefits issues that are important to employees.”

Financial Plan

“I think the financial plan is done well, said Tom. They really thought through all the important issues. They calculated a breakeven analysis, did a five-year forecast and a pro-forma balance sheet.”

“Yes, replied Joe, “but is it realistic?” “They forecast sales of 110,100 apps in the first year to create a revenue stream of \$879,699. That does not seem realistic to me.”

“I agree, said Jimmy, I can’t see generating that that kind of activity early in the process, especially given the number of competing apps and web sites.”

“Of course, opined Tom, they may believe that some of those sales will come from people leaving the present app and switching to G-Free or simply adding G-Free together with their present app to supplement access to new or different information, like the cosmetic function in G-Free.”

Joe added, “I noticed they made no considerations for salaries and wages. Obviously that cannot be. I think, like most students and nascent entrepreneurs in this situation, they plan to work for nothing and take the profits as reward for their labor. They do not realize that profits are the reward for risking their capital in the business and that if they also work in that enterprise, they are entitled to fair wages for their labor. I seem to recall that by not claiming any labor expense, that profit is overstated and taxes may be higher than necessary.”

“I think that’s right, said Jimmy, but what should we include in our analysis as a number for labor?”

“I believe, in order to answer that question, replied Joe, we need to decide how many people we need to operate the business and what should be each person’s functions.” “Each function will have a specific cost associated with it and then we can determine a number to plug into that column to account for wages and salaries.”

Tom offered the following, “I noticed they identified the break-even point as 10,504 apps, or \$83, 928.” “Now that seems very reasonable and doable in the first year.”

“Yes, I agree, replied Jimmy, Which means this venture can become profitable very early in its lifecycle.” “But their analysis is a bit confusing. They use the same figure, 83,928 as both breakeven revenue and total fixed costs. Is that just a coincidence or a mistake?”

“The students use a figure of \$54,900 for rent as part of their overhead, says Joe, We can eliminate or reduce that figure to lower our SGA and reduce our break-even number. That might make this opportunity more appealing.”

“That raises another issue, replied Tom, and nowhere in the plan is there a number for initial capitalization. How much will be needed to launch this venture?”

“From my viewpoint, said Jimmy, not very much. I think the students did a fairly good job identifying the start-up costs on the last page of the executive summary. Of course, we can challenge those numbers and replace them, but the results will probably not be much different.”

The discussion continued. Many other questions were raised about funding the venture. Was it worth further investigating the industry to determine if the data used in the plan was accurate? What else needed to be researched that might have been missed by the team of students? The biggest issue was determining if it was feasible for them to fund the idea at all. Were there any additional risks not covered in the business plan? CLC was unsure how to utilize the students if they insisted in participating in managing the operation.

EXHIBIT 1

Executive Summary

Over half of the adult community owns and are active users of smart phones. About 21 million people suffer from some type of gluten sensitivity and many more choose to live a gluten-free lifestyle. To put it into perspective if gluten-free were a state it would be the 5th most populous after Florida and the amount of people who want to reduce or eliminate gluten from their diet is five times the number of visitors to the Golden Gate Bridge each year at 74 million. The majority of these people use multiple apps to find information such as ingredients in certain food products, gluten-free recipes, and restaurants that have a gluten-free menu. But what if users could use one simple app to find this type of information and more? It would save them time and the hassle of searching multiple pages to get the answers they want. The G-Free App is the one solution to this ongoing struggle that users face every day.

Product

The G-Free App is a start-up company based out of North Andover, Massachusetts that looks to enhance the lifestyles of those who suffer from celiac disease, gluten sensitivity or who choose to live a gluten-free lifestyle. With The G-Free mobile application, consumers will no longer face the feeling of having no choices. This app allows consumers to choose from a variety of options for food products, restaurants and cosmetic products that are safe to use with a gluten allergy, all at the tip of their fingers. It gives our consumers the wonderful feeling of choice instead of being told one thing that they can have. There will be five different categories to the application – a barcode scanner, an ingredients list, a recipe sharing service, a “restaurants with gluten-free menus” service, and a cosmetics section – each directing the user to a new page. Within the categories are distinctive materials that allow the user to access their desired information.

COMPLETE CASE AND TEACHING NOTES SENT UPON REQUEST