

PAY-ME

**Growth Strategy
Payments**

**Low difficulty
Interviewer-led case**

PAY-ME discusses the growth of a new payments service for ad-hoc shift workers. The case covers all dimensions of the case interview scorecard, with a particular emphasis on numeracy.

Problem definition

Your client is a start-up that has created a payment service designed for independent workers who typically work 1-10 days for tens of employers in a given year. The independent workers using the service are varied and include independent doctors, nurses, security guards and brand ambassadors, amongst others. The service solves a common pain point for these types of workers: delayed payment for their work.

For example, if an independent security guard were to work for a shopping centre for the first time, and on a one-off basis, she may not be paid until 2-3 months later due to the time taken by the employer to register her with the relevant payment processor.

PAY-ME solves this problem by paying the worker for the shift on the day and then collecting the payment back from the worker as a direct debit a few months later when the worker is paid by the employer. The worker must submit a photo of their timesheet to PAY-ME via email using a camera phone and must set up a direct debit payment to return the payment to PAY-ME 1-3 months later.

The whole process takes place between just PAY-ME and the worker, so there is no communication between the employer and PAY-ME. The PAY-ME team has offered this service for free in a "beta" format for 6 months and has built a client base of 5,000 workers.

After this initial testing phase, the team now wants to start generating revenue and scale up the number of users.

The team have asked for your help to determine how much they should charge and how to grow the user base.

Question 1 (Structuring)

How would you structure your approach to the problem?

Additional information

- If asked, please share that PAY-ME's primary objective is rapid but sustainable profit growth.

Possible answer

1. How much can PAY-ME charge?

a. What should the price per transaction be?

- Value-based pricing: What is the value of an early payment for the user?*
- Cost-based pricing: How much does the service cost PAY-ME to offer? E.g., bank charges, risk of bad debt, cost of capital*
- Competitor-based pricing: What do similar services charge? E.g., pay-day loans*

b. What revenue model should PAY-ME use?

- Variable*
- Fixed*
- Subscription*

2. How can PAY-ME reach more customers?

a. Who should PAY-ME target?

- Expand within current customer groups: Assess which customer types have highest lifetime value and seek these out*
- Reach new customer groups, e.g., ad-hoc workers in the film or TV industry, events staff, etc.*

b. How should PAY-ME reach them?

- Using current customer base e.g., referral incentive*
- Beyond current customer base e.g., targeted social media ads, partner with industry players such as security personnel training providers to advertise to their customers*

3. Capabilities & risks

- Capabilities: capital (funds needed to finance marketing, worker loans, etc), tech, labour*
- Risks: regulation on usury rates, worker default, interest rates squeeze*

Question 2 (Numeracy)

The team is considering charging a fixed fee per transaction, and aims to achieve £1.50 profit per transaction.

The fixed costs of running the service (labour, technology, etc.) are £100,000 annually for a target volume of 500,000 transactions. Variable costs include transaction fees of £0.50 per transaction as well as the cost of capital for PAY-ME which sits currently at 3% per annum paid monthly.

If the average shift payment is £300 paid back in 2 months, what price must PAY-ME charge per transaction to achieve a target profit of at least £1.50 per transaction?

Additional information

- If needed, please share that the frequency and cost of bad debt is currently unknown and not included in the given costs.
- If needed, please share that the cost of capital for each transaction is calculated by applying the monthly percentage cost of capital to the payment for each month until it is repaid.

Possible answer

PAY-ME must charge more than £3.70 to achieve the desired profit per transaction. £3.70 is just over 1% of the average shift value, which feels reasonable given typical credit card charges are similar or higher. I would want to test a £3.70 fee against even higher fees (e.g., £5, £10) to see if uptake reduced.

Minimum price per transaction = Fixed costs per transaction + Cost of Capital per transaction + Variable Cost per transaction + Target profit per transaction

a) *Fixed costs per transaction = (Total Fixed Costs/Production Volume) = (100,000 / 500,000) = £0.20*

b) *Cost of capital per transaction*
3% p.a. is 0.25% per month (3% / 12 = 0.25%), so 0.5% for 2 months. Cost of capital over 2 months for a £300 shift = £300 x 0.5% = £1.50

Minimum price = (Total Fixed Costs/Production Volume) + variable cost per unit + cost of capital + Target profit per transaction
= 0.20 + 0.50 + 1.50 + 1.50 = £3.70

Given that this analysis does not account for the cost of bad debts, I would want to investigate this risk and understand the cost associated.

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Question 3 (Creativity)

The team is concerned about the risk of failed repayments by workers if they cancel the direct debit or if the payment to PAY-ME bounces.

How could this risk be mitigated? Please think creatively to identify mitigating actions to the risk.

Possible answer

Mitigation strategies:

1. "Carrot":

- a) *Continued communication with the customer e.g., text message with "your payment will be taken in 2 days" to avoid bounced payments*
- b) *Limit number of transactions per customer until their payback rate is seen to be good – customers are rewarded for use of PAY-ME with an increasing transaction limit on their account*
- c) *Customers receive "reward points" with increased use of the service, which increases loyalty*

2. "Stick":

- a) *Customer signs contractual agreement*
- b) *Set up communication with the bank so PAY-ME is immediately aware of cancelled direct debit*
- c) *Contact customer with failed payment directly via phone to discuss*
- d) *Remove customer from the service*
- e) *Use formal debt collection process*

Question 4 (Judgement and Insights)

PAY-ME has grown their customer base to 5,000 over the last 8 months using non-scalable methods, such as posting on online forums and social media. The PAY-ME team has brainstormed four options for increasing the number of users in a more sustainable way and has created the following table (share Exhibit 1).

Based on this information, which option(s) maximize the profit per customer? Which method do you recommend PAY-ME use to sustainably grow their user base?

Additional information

In order to answer whether the channels will grow PAY-ME sustainably, the candidate should ask for the Customer Lifetime Value. If the candidate does not ask, provide it.

- Average lifetime value of a customer is £30.

Possible answer

1. *With the lowest cost per sign up at £2.50, affiliate promotion is the most profitable acquisition method. The Customer Lifetime Value is £30, a 12x return on the cost per sign up. Still, since referral incentives are also very attractive (£3.33 per sign up), PAY-ME should also implement referral incentives. Both would be sustainable channels for growing the business.*
2. *These channels will reach different types of customers - the referral incentive will reach only the friends of current users and be limited by the current number of users, whilst the affiliate promoters will broaden PAY-ME's reach beyond its current type of customer. However, it may take time to find the right affiliates to promote PAY-ME.*
3. *Social media advertising and telephone sales are the least effective approaches, because the success rate is 10% and cost is comparatively high*

Acquisition method	Cost to implement per 100 people (£)	Cost per sign up
Referral incentive	100	$100 / (100 * 30\%) = £3.33$
Affiliate promotion	50	$50 / (100 * 20\%) = £2.50$

Exhibit 1: Potential customer acquisition methods

Acquisition method	Cost to implement per 100 people (£)	Success rate
Referral incentive	100	30%
Social media advertising	200	10%
Affiliate promotion	50	20%
Telephone sales	100	10%

Definitions:

Referral incentive – current customers can refer friends to PAY-ME and receive rewards such as a zero fee for their next use of PAY-ME

Social media advertising – for example, targeted Facebook or Instagram adverts

Affiliate promotion - a company related to the industry who would advertise the PAY-ME service to their members, such as a shopping centre sending an email to all their security guards

Telephone sales – use a call centre team to research and approach potential new customers over the phone

Question 5 (Synthesis)

Based on the information you have assessed so far, what would you recommend PAY-ME do to increase their customer base in a profitable way?

Possible answer

1. *We were asked how PAY-ME should go about introducing a transaction fee while profitably scaling its customer base. I recommend PAY-ME use a referral incentive and affiliate promotion to expand their customer base and charge at least £3.70 per transaction for their service. This is for two reasons:*
 - a) *£3.70 meets PAY-ME's target profit of £1.50 per transaction and is just over 1% of the average shift value, which seems reasonable compared to credit card fees, and very reasonable compared to traditional pay-day loans*
 - b) *Affiliate promotion and referral incentives have a higher payoff than other available marketing methods (with a £2.50 and £3.33 cost per sign up respectively) and each will reach different types of customers. Both are sustainable strategies with a customer LTV of £30.*
2. *My next steps would be to set up a test to see what impact a £3.70, £5 or even £10 fee has on customer uptake, to determine which fee would generate the most profit.*
3. *I would also want to estimate the likely risk of bad debt and determine how this could be **built into** the fee to ensure long-term profitability for PAY-ME.*