

# **Sneek-Peek Inc.**

**You Need to See It First™**



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## **Product Development Proposal:**

Virtual Vacation-Rental Walkthrough

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# Product Development Proposal: Virtual Vacation-Rental Walkthrough

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## Executive Summary

There seems to be an opportunity to develop a profitable business providing advertising and rental-property preview services to a variety of market segments. The most approachable and rapidly-developable segment seems to be that of luxury and resort hotel properties. Six organizations control almost 75% of the rooms available in this market, making the sales cycle required to achieve deep market penetration very approachable.

The services provided to this market would go far beyond traditional brochure and web-based advertising campaigns, allowing potential guests to virtually walk through these properties and potentially interact with the various amenities included in the property. We believe that this type of virtual pre-visiting of the vacation properties could be a game-changing advancement offering a significant competitive advantage to our customers and providing our company with a leadership position in a new market space.

While this new market goes far beyond the luxury hotel segment, this segment alone appears to be a \$12.9 million dollar market. Since this would be our first segment in the virtual-preview market, we have not attempted a market-sizing analysis beyond this segment. This report includes financial projections and a preliminary operations analysis projecting expected margins ranging from 19% in the first year through 26% by year five. These margins yield a net income ranging from \$79,000 in year one through \$243,000 in year five. These projections demonstrate increasing margins and falling variable costs, indicating a scalable business model that will allow us to develop into other market segments.

The enabling technology for this project is a virtual-world called **Second Life™** (SL™). This virtual world is relatively easy to use with respect to the basic functions needed to enable the virtual preview. Additionally, since SL is already a commercial product with a large registered user base, and a cost structure targeted at individuals, the enabling technology for the virtual preview is the least costly component of the proposed business model.

The development team is seeking \$75,000 for phase I. This phase will include the additional market research and technology development required to produce a detailed business plan. If the business plan passes the first stage-gate, then the development team will be seeking approximately \$300,000 to develop the project into phase II. Phase II will include final technology development, personnel training, and a pilot program providing these services to actual customers. The \$300,000 estimate for phase II is subject to revision based on the market research and business plan.

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## Opportunity

Individuals and families often travel for vacation. When these travelers reach their destination they need accommodations. In some cases, such as casinos and beachfront rentals, the accommodations are the reason for the trip. However, whenever a family travels to a new location, they are taking a risk. That risk is that the property will be a disappointment.

No one wants to book a once-in-a-lifetime family trip to the beach, perhaps before the kids leave for college, only to be disappointed in the property. Such a problem can ruin a trip and generate a lifetime of negative word-of-mouth publicity for the rental company. These problems can arise despite the company's best efforts. Even a clean and well-maintained property can be a disappointment for the guest, and the factors leading to this disappointment are beyond the control of the rental company. The two main issues that can cause a clean and well-maintained property to disappoint a guest are the size and layout of the rooms, and the position of the property in its environment.

The brochure may say "spacious rooms," but the guest finds them barren. The rooms may be listed as "cozy," but the guests find them small. The brochure may say "near the beach," but the guest finds that two blocks is too far. Sadly, in situations like these, both the rental company and the guest are right. A property that is delightful to some customers will be completely unacceptable to others. It is in the best interest of both the rental company and the guests that the property meets expectations. This problem comes down to managing expectations; about communicating both the details, and the feel of the property, to the potential guest.

Every rental company provides brochures and web-site photographs to help their guests get a feel for the property, and the guests use this information to make the buy decision. Any company with an edge in this part of their marketing will have a competitive advantage. What the rental company needs is a way for the guests to visit the property **before** visiting the property; a virtual visit. This is where **Sneek-Peek Inc.** can provide value.

## Proposed Solution

In the past few years there have been significant advancements in computer technology. One area of advancement, driven by the computer-gaming market, is the ability of the computer to generate realistic on-screen environments. Another area of advancement is the pervasiveness of the Internet. Several companies have combined these technologies, not to create games, but to create lifelike virtual worlds. One of the most well-know and successful of these companies is **Linden Lab**<sup>®</sup>, creators of "Second Life<sup>®</sup>," or "SL<sup>™</sup>."

Our proposal is to use Second Life (SL) to allow a potential rental-property customer to virtually visit a property before committing to rent it. We would, in collaboration with the rental-property company (our customer), not only build virtual models of the rental properties, but virtual models of the entire landscape around the property.

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Our ideal customer would have multiple properties in a resort community. By building the virtual landscape, complete with all properties, potential guests could walk from room to room, look out the windows, go outside, and even visit other rental units or the virtual beach. This would allow the guests to get a feel of the property, the size of the rooms, the view from the windows, and examine any detail in which they have an interest or concern. The potential guest could visit the property **before** visiting the property; they could take a **Sneek-Peek**.

### Second Life as an Enabling Technology

SL is a virtual planet, and like Earth, it is mostly covered by water. Customers can create “islands” where they build their virtual presence. The earth and water on these islands can be shaped into hills, valleys, rivers, ponds, and lakes. These capabilities will allow us to shape the contours of the virtual landscape to match the contours of the actual landscape. Once the topography is correct we can build the virtual rental properties.

In SL, buildings are assembled from primitive objects called “prims.” Prims can be shaped and proportioned, and then arranged into groups. Additionally, prims can be “textured,” which in the world of computer graphics means that they can be covered by an image or photograph. To assemble the virtual rental properties, our task would be to use prims, covered by photographs of the actual rental property to provide a virtual duplicate of each of our customer’s rental properties, and place these properties in the appropriate location in the virtual rental community. Once the virtual community is completed, potential guests can walk around the virtual community and decide which property they would like to rent. Seasonal schedules and available dates would be provided inside each rental property, so the customer can see which properties are available to match their vacation dates.

### Marketing Effects

The underlying assumption of this product proposal is that potential guests want to make an informed choice when selecting vacation rental. When the potential guest is selecting between properties with appropriate availability and features, the guest will select the vacation rental that offers them the clearest and most reliable information. In essence, with all other factors being equal, the guest will select the property that offers them the most certainty that the property will not be a disappointment. This assumption will have to be supported with appropriate market research.

If this above assumption holds, then guests will select properties that offer the virtual preview over properties that do not. This means that a large section of the competition will be eliminated from consideration before the guests have even evaluated their offerings. This has three implications.

First, the implication for the rental company is a narrowing of the competitive field. This allows them to differentiate themselves against a smaller field of competition, and simplifies the development of a market position.

Second, the companies that have been eliminated from the field of competition will need to establish the virtual-visit capability in order to remain competitive.

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Finally, if we can push the technology to the first bend in the S-curve, potential customers wanting to return to the competitive field will seek us out, thus increasing our revenue at the very moment that we will be facing developing competitive threats. So the question becomes “how do we push this to the first bend in the S-curve?”

### Financial Analysis

A financial analysis in a product proposal is, by necessity, a rough estimate based on numerous untested assumptions. The following sections use available research where possible, and states assumptions when they are used. The analysis begins with target-market size.

#### Target Market Size

MINTEL Oxygen provides an excellent starting point for market research relating to vacation travel. Since this is an early-phase project, maximizing revenue while minimizing operating costs is paramount. To that end, we are focusing on ‘destination accommodations,’ places to which people travel because of the accommodations. This places us in the area of high-end and casinos hotels. According to the MINTEL Oxygen report “Hotels and Accommodations - US - September 2008<sup>1</sup>,” this market has revenues of \$162.3 billion (2007), with revenue expected to grow slowly due to current US economic conditions, noting that “Luxury hotels have performed particularly well and are least likely to feel the affects [sic] of the downturn in the U.S. economy.<sup>2</sup>”

Another interesting note from this report is that while casino hotels have, historically, focused on attracting guests interested in gambling, these hotels are attempting to grow revenue through attracting non-gambling guests. They are accomplishing this by offering other entertainment activities such as “major entertainers”, “Broadway-style theater and fine dining” and “& Wine Festival featuring celebrity chefs and wine tasting.<sup>3</sup>”

In this report, the data most relevant to this project is data about advertising expenditures and booking methods. According to the MINTEL report, advertising expenditures for media are significant.

Media expenditures for the lodging companies with the Brandweek Superbrands Top 2000 increased 2.2% between 2006/2007, compared to 10.2% in 2005/06. Each of the top five brands (based on room size) lays out between \$16-\$29 million a year (excluding online advertising).

The top five brands ranked by number of rooms (see World Ranking Figures in Leading Companies) each had more than \$16 million in 2007 media expenditures (excluding online advertising expenses):

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<sup>1</sup>

[http://www.library.ohiou.edu:2718/sinatra/oxygen\\_academic/my\\_reports/display/id=297930&anchor=atom#atom0](http://www.library.ohiou.edu:2718/sinatra/oxygen_academic/my_reports/display/id=297930&anchor=atom#atom0), Accessed 10/26/2008 10:27 AM

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

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- Best Western \$23.7 million
- Holiday Inn \$15.9 million
- Days Inn \$16.6 million
- Marriott \$16.2 million
- Hampton \$28.5 million.<sup>4</sup>

Media expenditures for the leading brands above increased 2.2% between 2006 and 2007, reaching \$479 million in 2007. Although television still commands a significant portion of an advertising budget, spending on online advertising and promotions has increased.

As noted above, while the media expenditures are significant, online advertising has increased. This may be in response to the booking methods uses by the guests. Again, from the MINTEL report:

The two most often cited methods for booking a hotel room for leisure purposes are done directly with the hotel. Some 38% of adults say they make the reservation over the phone with the hotel; another 27% say they make the reservation via the hotel's website. **This direct communication provides significant opportunities for upselling, promoting the hotel's offerings, and making a positive impression. These critical touch points should not be overlooked.** As websites continue to evolve, making use of interactive tools, such as live chats or assistance, may help foster this communication avenue<sup>5</sup>. [Bold as in the original]

The reason that the brands may have such a reactive response to the usage of online booking is that online booking is, in part, driven by the methods that potential guests use to identify the hotels at which they will stay. Again from the MINTEL report:

Online sources have also taken on considerable importance. About four in 10 adults searched the hotels website directly, while three in 10 searched online through internet travel sites. Although online method usage is higher for younger adults, it is prevalent among all adults, with the exception of those aged 65+. **To attract customers, hotels must have clear and enticing marketing materials on their own and third-party websites**<sup>6</sup>. [Bold as in original]

While the MINTEL report did not provide specific online promotional budgets, we used a per-booking division of the advertising budget, with an adjustment factor (a complete guess) to adjust for differing media costs. In particular, placing information and interactivity on a hotel web site is probably significantly less expensive than buying television or radio slots.

Given the media expenditures and the relative costs of online advertising, the following table provides an initial estimate of the target market size:

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<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

<sup>6</sup> Ibid.

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Table 1

Advertising expenditure (excluding online): \$479 million
27% book using the web site: $\$479 * 0.27 = \$129.33$ million
<b>Low Estimate</b> (5% factor): $\$129.33 * 0.05 = \mathbf{\$6.46}$ million
<b>High Estimate</b> (15% factor): $\$129.33 * 0.15 = \mathbf{\$19.40}$ million
<b>Average:</b> $(\$6.46 + 19.40) / 2 = \mathbf{\$12.9}$ million

Given the above assumptions, this market is worth \$12.9 million annually. This estimate covers only one market segment, the hotel industry. Conspicuously missing from this estimate is the vacation rental properties segment. This segment would include properties such as beach-houses and mountain resorts. This \$12.9 million estimate is used only to establish an initial break-even analysis for an initial target market. We believe that this market is reachable, and that achieving significant market penetration in this segment is possible because this market is highly concentrated. Again, according to the MINTEL report:

Six hotel groups account for 75% of the hotel rooms in the U.S. from the top 50 hotels. All of the leading brands in the U.S., ranked by number of rooms, are top 10 global brands.

This means that closing deals with only six customers will allow us to represent almost 75% of the hotel rooms in the US. Developing these deals quickly is critical to achieving early market domination as well as establishing a revenue stream that will allow us to penetrate the other segments while competitors are working to develop the supporting technology. So, “how much will it cost to develop this segment?”

### Operations Analysis

There are two aspects to the operations analysis; land acquisition and model development.

Identifying the cost of the land acquisition component is easy. From the SL web site, acquiring 65,536 square miles of land requires a setup fee of \$1,000 with a monthly maintenance fee of \$295<sup>7</sup>. Initially, one region should be sufficient for this project.

Model development is a relatively straight-forward 3D-modeling task. One advantage of selecting the luxury / casino hotel segment as the initial segment is that it minimizes the number of unique rooms/suites that have to be modeled. Initially, we could simply model the entire building as a single structure. This would include the lobby, restaurants, and special components such as pools and spas. Once the common areas are complete only a few models for the unique rooms/suite models are needed. This is based on the assumption that rooms and suites are generally replicated throughout the hotel.

Since we are trying to establish the market, it is probably a good idea to establish a “setup fee” for each property, and then waive it for some of the properties belonging to the six large players in the market. Assuming that a skilled 3D modeler could model each property in one week, and that the customer

<sup>7</sup> <https://secure-web14.seconlife.com/land/privatepricing.php>, Accessed 10/26/2008 11:27 AM



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would provide the accommodations for the modeler, we would only need to cover wage and travel expenses.

Given salary of \$45,000<sup>8</sup> per year for the 3D modeler and a loading factor of 1.5 to cover benefits and such, the wage expense comes out to \$1,350 per week<sup>9</sup>. Assuming approximately \$2,000 in round-trip air-fare, we have a cost of \$3,350 per hotel/casino property. Even if we did not waive the setup fee, this is a fairly small price for the property manager to pay to get the property completely modeled and available online.

The next thing we need to know is “how many models do we need to make?” The answer to this question comes down to how many luxury properties the five largest players have. NOTE: While the six largest brands dominate the market, we are focusing on the top five advertisers, the same group that was used to develop the target market size. We make the assumption that many of the properties in these chains are normal hotel/motel properties, and that luxury or casino properties are relatively rare within each chain’s holdings, constituting between 1% and 5% of total properties.

Table 2

Hotel Chain	Total Properties	Low Estimate (1%)	High Estimate (5%)
Best Western	4,000 <sup>10</sup>	40	200
Holiday Inn (Intercontinental Hotel Group)	4,000 <sup>11</sup>	40	200
Days Inn (Wyndam Worldwide)	6,500 <sup>12</sup>	65	325
Marriott	3,000 <sup>13</sup>	30	150
Hampton (Hilton Family)	3,000 <sup>14</sup>	30	150
<b>Totals</b>	<b>20,500</b>	<b>205</b>	<b>1,025</b>
<b>Average (205 + 1,025) / 2 = 615</b>			

We are estimating that we could achieve approximately 75% market penetration by creating approximately 615 models. We would have to waive the setup fee for the first few hotels in each chain, and then stop waiving it as we progress through their properties.

### Financial Projections

Based on the above assumptions, we have developed a set of financial projections. The details of these projections are available in the appendix. This section provides a summary of these projections.

<sup>8</sup> [http://www.payscale.com/research/US/Job=Graphic\\_Artist\\_%2F\\_Designer/Salary](http://www.payscale.com/research/US/Job=Graphic_Artist_%2F_Designer/Salary), Accessed 10/26/2008 11:49 AM

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<sup>9</sup> Assuming a 1.5X loading factor and 50 weeks per year.

<sup>10</sup> <http://www.bestwestern.com/newsroom/faq.asp#Q1>, Accessed 10/26/2008 11:56 AM

<sup>11</sup> <http://www.ihgplc.com/>, Accessed 10/26/2008 11:59 AM

<sup>12</sup> <http://www.wyndamworldwide.com/about/>, Accessed 10/26/2008 12:03 PM

<sup>13</sup> <http://www.marriott.com/corporateinfo/default.mi>, Accessed 10/26/2008 12:04 PM

<sup>14</sup> [http://hiltonworldwide1.hilton.com/en\\_US/ww/fob/aboutUs.do](http://hiltonworldwide1.hilton.com/en_US/ww/fob/aboutUs.do), Accessed 10/26/2008 12:25 PM

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As shown in Figure 1, we adjust the number of 3D modelers, starting with two and increasing the number to four, so that we reach our target number of properties (615) within five years. This allows us to develop a capacity of 150 models per year while remaining profitable.

Figure 1



As expected, Figure 2 shows that as the number of properties under management grows, the cost per unit goes down. This indicates that revenue per unit exceeds variable cost, and allows us to be profitable throughout the projected time period.

Figure 2



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It is worthwhile to note that these projections are based on averages from a pair of best and worst-case scenarios. In the spirit of full disclosure on the range of the projections on which these graphs are based, the following figure (Figure 3) shows the profit (revenue – expense) for both of these scenarios.



There are a variety of factors that differentiate these scenarios. These factors include:

- The amount of the setup fee (ranging from \$2,000 to \$5,000)
- The % of the setup fees that are waived to get the project started (1% to 5%)
- The monthly fee for our services (\$200 to \$500)

These three factors allow for eight possible projections based on different combinations, so Figure 3 could contain as many as six additional projections between the best and worst case scenarios.

### Potential Follow-On Markets

With a capacity of 150 models per month, and once the luxury hotel and casino market is under control, we can expand into other markets. These markets could include luxury resorts, retirement communities, beachfront vacation communities, and a variety of other options.

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Beyond the obvious rental markets, options such as rest-home properties and ultra-high-end residential properties could also be considered. These markets may have different cost structures, but they will allow for continued growth for many years.

### **Funding Requirements**

As the financial projection in Appendix A shows, we expect first-year operating expenses of approximately \$150,000. We are requesting a first-year operating budget of \$300,000 to allow for experimentation, model development, market research, and the sales costs associated with getting the project started. Optionally, an initial budget of \$75,000 would allow us to develop our market research and refine the financial models. Please note that there is not a lot of room between these two numbers. While we can certainly develop our market research for \$75,000, doing anything beyond market research and financial modeling will require the full \$300,000. These two jumps in funding requirements represent project stage-gating opportunities.

If we are funded the initial \$75,000 we will be able to develop the market research and financial models as stage one. If the management board finds the business plan acceptable, the board can gate the project to stage two.

### **Next Steps**

If the board is interested in more information, we are ready to do a presentation about the underlying technology, and to answer questions afterwards.

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## Appendix A – Financial Projections

	Assumptions	Year 1	Year 2	Year 3	Year 4	Year 5
<b>Expense</b>						
Startup Costs	\$ 1,000	\$ 1,000	\$ -	\$ -	\$ -	\$ -
Monthly Maintenance Fee	\$ 295	\$ 3,540	\$ 3,540	\$ 3,540	\$ 3,540	\$ 3,540
<b>Total SL Fees</b>		\$ 4,540	\$ 3,540	\$ 3,540	\$ 3,540	\$ 3,540
Number of Modelers		\$ 2	\$ 3	\$ 4	\$ 4	\$ 4
Working Weeks	\$ 50					
Models per Week	\$ 1					
Modeler Loading	\$ 1					
New Properties (at Capacity)		\$ 75	\$ 113	\$ 150	\$ 150	\$ 150
<b>Total Properties</b>		\$ 75	\$ 188	\$ 338	\$ 488	\$ 638
Modeler Salaries (Base)	\$ 45,000	\$ 45,000	\$ 46,350	\$ 47,741	\$ 49,173	\$ 50,648
Increases (COL)	\$ 0					
Loading	\$ 2					
Salary per modeler		\$ 67,500	\$ 69,525	\$ 71,611	\$ 73,759	\$ 75,972
<b>Total Modelers</b>		\$ 135,000	\$ 208,575	\$ 286,443	\$ 295,036	\$ 303,887
<b>Sub-Total Operations</b>		\$ 139,540	\$ 212,115	\$ 289,983	\$ 298,576	\$ 307,427
Administrative Load (% of ops)	\$ 0	\$ 6,977	\$ 10,606	\$ 14,499	\$ 14,929	\$ 15,371
<b>Expenses (Ops + Admin)</b>		\$ 146,517	\$ 222,721	\$ 304,482	\$ 313,505	\$ 322,799
<b>Expense per Property (Variable Cost)</b>		\$ 1,954	\$ 1,185	\$ 901	\$ 642	\$ 506

<b>Revenue</b>						
Pricing (Charge to Customer)						
Setup Fee (Low Estimate)	\$ 2,000	\$ 150,000	\$ 226,000	\$ 300,000	\$ 300,000	\$ 300,000
Setup Fee (High Estimate)	\$ 5,000	\$ 375,000	\$ 565,000	\$ 750,000	\$ 750,000	\$ 750,000
Waived Setup Fees (Low % of Properties)	\$ 0	\$ 1,500	\$ 2,260	\$ 3,000	\$ 3,000	\$ 3,000
Waived Setup Fees (High % of Properties)	\$ 0	\$ 18,750	\$ 28,250	\$ 37,500	\$ 37,500	\$ 37,500
Low Setup Fees (Low Fee - High Waive)		\$ 131,250	\$ 197,750	\$ 262,500	\$ 262,500	\$ 262,500
High Setup Fees (High Fee - Low Waive)		\$ 373,500	\$ 562,740	\$ 747,000	\$ 747,000	\$ 747,000
Per Month Fees (Low Estimate)	\$ 200	\$ 15,000	\$ 37,600	\$ 67,600	\$ 97,600	\$ 127,600
Per Month Fees (High Estimate)	\$ 500	\$ 37,500	\$ 94,000	\$ 169,000	\$ 244,000	\$ 319,000
Revenue (Low Estimate)		\$ 146,250	\$ 235,350	\$ 330,100	\$ 360,100	\$ 390,100
Revenue (High Estimate)		\$ 411,000	\$ 656,740	\$ 916,000	\$ 991,000	\$ 1,066,000

<b>Gross Margin</b>						
Low Estimate		\$ (267)	\$ 12,629	\$ 25,618	\$ 46,595	\$ 67,301
High Estimate		\$ 264,483	\$ 434,019	\$ 611,518	\$ 677,495	\$ 743,201
Tax Rate	40%	\$ (107)	\$ 5,052	\$ 10,247	\$ 18,638	\$ 26,921
Low Tax Expense		\$ 105,793	\$ 173,608	\$ 244,607	\$ 270,998	\$ 297,281
High Tax Expense						
Net Income (Gross Margin - Tax Expense)		\$ (160)	\$ 7,578	\$ 15,371	\$ 27,957	\$ 40,381
		\$ 158,690	\$ 260,412	\$ 366,911	\$ 406,497	\$ 445,921
Low Margin Estimate		0%	3%	5%	8%	10%
High Margin Estimate		39%	40%	40%	41%	42%

<b>Execrated (Average) Profit and Margin</b>						
Expected Profit (Average)		\$ 79,265	\$ 133,995	\$ 191,141	\$ 217,227	\$ 243,151
Expected Margin (Average)		19%	21%	22%	24%	26%