NEW BUSINESS VENTURES

Analyzing the Market
In the last lecture, you considered the question "Who cares, and why?" as you explored your idea for a new venture. Another way of phrasing that question is, "Who's going to buy this?"

A more technical term for the second line of questioning is market analysis, the topic of this lecture. A follow-up to that question that will be discussed in the next lecture is, "How else are people satisfying their needs today?"

Together, these questions form the most critical issues you face when putting together a business plan. A business plan is a document that lies out the “who, what, when, where, why, and how” of your potential business. While formal business planning is outside the scope of this course, you can find more information in the readings and in later lectures to guide you in important aspects. For now, we will dive into the heart of any sensible plan for launching a new product or service: market analysis.

**Sizing the Market**

All too often, when you ask an entrepreneur “Who's going to buy this?” the answer is, “Everybody,” or “It depends,” or “I'm not sure yet, but it's a cool enough product that somebody must want it.”

That’s not going to cut it.

To really know whether it’s worth investing time and resources in building a business you have to size the market opportunity. And here, the bigger the market, the better. If it’s going to cost you $10 million to develop a product that is useful to only 100 people, each of whom is willing to pay $10 for your product, then obviously that’s not a very interesting business proposition—even if the product is amazing and works just like you promise it will.

Two commonly used approaches are “top down” and “bottom up” market sizing.

In the top-down view, you look at the entire population, and determine what percentage of it you might be able to serve. For example, if you think you’ve got a solution to the common cold, you might learn that 100 million people suffer from colds each year. You might also discover that last year people spent approximately $3.5 billion on over-the-counter cold medicines in the U.S. Many entrepreneurs fool themselves into thinking that all they have to do is capture 1 percent of that market—and bingo! —they’ll rake in sales of $35 million. That may well be the case, but how do you know you can capture any of the market?

Another approach is to work from the bottom up. With this method, you look at what you can realistically sell given your available means. You could note that you live in a town with 10 drugstores, that you have two salespeople, and that they could conceivably pound the pavement for 10 hours a day. You could calculate how long it would take you to call on each of the pharmacists at these drugstores and measure the foot traffic and total sales in each of the stores. With some quick calculations you could estimate how much cold medicine you might be able to sell in a month.

If you have an entirely new product category, look at potential customers in related markets and their spending habits and technology-adoption history. For example, if you had been the first person to bring the light bulb to market, it would have been impossible to measure the amount of money people spent on light bulbs. But you could have looked at sales of candles, whale oil, and other substitutes.

**Picking the Right Market**

Let’s look next at how to determine the size and dynamics of a target market. Two terms used here are total addressable market and initial target market.
For the sake of discussion, imagine that you’ve developed a new method for sharpening cutting blades. To calculate your total addressable market, you might add up all of the people in the world who do any sort of cutting: surgeons, machine-tool operators, chefs, lumberjacks, and so on. You could look at such sources as industry reports, census data, analyst projections, and annual reports from public companies to calculate the total addressable market.

That’s a long list of potential customers, and there are many ways to approach buyers in each of those groups. You can’t possibly do it all. Just because there are millions of people in the world who might want to use your product doesn’t mean that they’re all going to appear at your door the day you open for business. You need to focus, and think about the group with whom you’re most likely to succeed.

You might decide that surgeons spend lots of money on sharpening, but they might be slow to make buying decisions, so you might not want to start with them. Loggers might be easy to reach if you live in a town near lots of trees, but they might be hesitant to embrace new technology. You might need to go after a less than ideal initial market as a way to generate some early sales and amass the resources needed to go after the more lucrative larger market later. You need to pick an initial target market, but which one? To figure that out, you have to understand how a potential market works.

Understanding Market Dynamics

Once you’ve identified a possible market, you’ll want to determine:

What do buyers spend now? Who do they spend it with? How do they make their spending decisions? What features are important to them? What overall values, quirks, and tastes do they have?

In the article you read by Bill Sahlman, he described the once-glamorous disk-drive industry as "a structural disaster area" back in 1997 when he was writing the article. And he called the information services industry then a "paradise." The hot industries today have naturally changed, but the questions you need to address have not. Surely, if given the choice, you’d rather sail away from disaster and into paradise. How do you know which way you’re headed? You’ll want to look at the trends:

Is the market growing, and how fast?

If you have invented a new type of headphone, for instance, you may look at the sales of iPods and other music players each quarter to estimate how fast your target market is growing.

What makes the market grow?

For example, new-home sales influence the market for lumber.

Is growth the result of an overall expanding market or customer switching?

If you are a cell phone manufacturer and notice that cell phone sales are increasing, the increase could be because (a) people who have never before owned cell phones are purchasing them, (b) more people are buying a second device, or (c) a combination of both factors. Based on the first scenario where first-time users are driving sales growth, you may choose to build simpler cell phones. But you might build phones with advanced features if second-phone purchasers are driving the market’s growth.

Why will people switch to your product or consider a new purchase?

A light bulb that provides light for 100 hours, when compared with a candle that lasts for three hours, has an important advantage your customers must be made aware of.

What are the product life cycles in your market and the required technology investments to stay ahead of the curve?

For example, if you manufacture vacuum cleaners, the product life cycle is relatively long. The market does not expect you to introduce a new model every three months. But if you develop software, product life cycles are relatively short and you will constantly be working on the next release. The resources you need to develop products are dictated to a large extent by the product’s life cycle and the investments required to stay competitive.
Who has buying power in your industry’s value chain?

If you are the manufacturer of a product that is distributed to consumers through a retailer, a large chain such as Wal-Mart has a high degree of buying power compared with the mom-and-pop store down the street. Wal-Mart can dictate terms that the smaller stores cannot, such as the price, quality, and delivery schedule your product must meet. More on this subject is in the next module.

Do external factors influence the potential size of your market?

Suppose you have an idea for a breakthrough vehicle that will provide transportation for people at a price point that is equivalent in cost to $2 per gallon of gasoline. If the price of gas is $4 per gallon, then you have an interesting value proposition, and a big market. If the price of gas is $1 per gallon, then you don’t. The size of your available market will vary based on factors that you don’t control. How will you plan for this?

It is also important that you look at market segments. There are many ways to do this, but here are a few examples to consider:

**Geography:** “Customers in the Northeast bought 60% more heating oil during the winter of 1999 than the average U.S. buyer”; **Industry:** “Financial services firms comprise 40% of the market for supercomputers”; **Type of buyer:** “Early adopters seeking a professional edge make up 40% of the market for BlackBerry phones”; **Distribution channel:** “30% of customers shop at Wal-Mart at least once a week”;

**Market share:** “Coke owns 45% of the market, Pepsi owns 40%, and assorted juice drinks own 15%.”

When trying to determine the size of the market for a new product, look closely at what you will be replacing. If it is a brand-new product category, you can estimate your initial sales roughly based on existing sales of substitutes. You can refine your estimates further based on consumer response to trial offers and the number of repeat users who return to purchase your product.

You will want to continually recalibrate your estimates based on what you learn as you try to sell your product. If results are lower than what you were hoping for, you should examine whether the product you’re trying to sell can be modified to be more appealing to a larger segment of the market.

To learn more about strategies for conducting market research and segmenting markets, glance back at the marketing course you took. Look as well to the readings for targeted strategies that apply to new ventures.

Picking Your Niche

Now comes the point where you have to decide. Once you understand the major sea changes that are under way in society, you have to make any number of educated guesses: how people are changing their behaviors, and which emerging technologies will have a profound effect on what people buy and how they buy it.

Then you must find a niche where you think you can make a difference. After you’ve picked your niche, follow these steps:

1. **Know the story:** Learn all you can about the history of the market. Why does this opportunity exist now? Who has come before you and tried to solve it in other ways? What is the source of the problems that you aim to solve? Understand the history of the market you’re about to enter in order to avoid repeating mistakes that have tripped up others.
2. **Identify experts:** Who understands this market today, and what are they saying about it? Who are the thought leaders whose opinions you want to cite in justifying the market need. Take the time to listen to expert opinions on the future of the market you want to enter.

3. **Learn how to keep score:** Which metrics will you measure to determine whether the market is adopting your solution? Metrics can range from “at least 40% of my customers must become repeat customers” to “my customer base should grow at least twice as big within 30 days.” Also establish what your next steps will be if a product is a runaway success, or not.

4. **Know how to keep ahead of the competition:** How will others respond to you, and how will you in turn respond to them? Study how competitors react to the introduction of your product and whether their responses are consistent with what you expected. (More on this is in the next lecture.)

About making that important choice, Jack Welch writes in *Winning*:

Starting a new venture ... means making a bet. Most people instinctively hedge their bets, even as they place them. The irony is that such hedging can doom a new venture to failure. When launching something new, you have to go for it—“playing not to lose” can never be an option (pp. 206–207).

Once you’ve placed your bet on a market, you have to give it everything you’ve got.