Defining a Market

in several painful steps

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I love start-ups. They are like small children exploring electrical outlets for the first time. The results are predictable, and when not fatal can be entertaining.

Many start-ups seeking guidance from Silicon Strategies Marketing ask about defining their markets. I typically respond by asking which market they are referring to and what brought them to my door. They are baffled by the former and admit that being shot down by investors caused the latter.

Trouble from the Start

"So tell me," a venture capitalists typically starts. "How big is your market?" Start-up founders then enthusiastically reply with some wildly large number that encompasses every homo sapiens on the planet (they restrict it to earth-bound hominids because it is difficult to place Amazon.com orders while in residence on the International Space Station).

"Okay. Is that your total, addressable, realistic or early-adopter market?"

At this point the poor founder hangs his head, realizing that he doesn't understand a common question posed by investors. The entrepreneur turns and scurries out of the pitch meeting like a child off to insert his nose in a room corner until recess.

Here is the issue, short and unsweetened: There are multiple definitions for your market, each one addressing a different audience for a different purpose, and these definitions change over time depending on many factors. If you don't have a handle on what is your actual market – what you can possibly address today and tomorrow – you are lost. Not only will most investors disregard your pitch, you dive into self-destructive decisions based on poor foresight.

The Market Onion

Each market definition tends to be a subset of others. In their meaningful hierarchy, the various market definitions are:

> **Total market:** Every possible buyer for the product, plus recurring revenues for follow-on services and replacements.

Addressable market: The buyers that you can actually reach and sell, which may exclude people already buying your competitors' products.

Realistic market: The market that you have a realistic chance of selling to.

Segment markets: The total of buyers in the segments for which you have a whole product.

Life-cycle market: The remaining addressable buyers, which are limited by where your product category is in the adoption life-cycle.

Defining each of these markets is important in guiding your company's operations and strategy, and for communicating to interested outside parties, including investors, analysts and the media. How you determine these market definitions is very complex, but we'll provide an overview.

Total market

The total market (a.k.a. the potential market) is the one that newfound founders routinely and incorrectly cite while romancing investors. They do so out of unbridled optimism and ignorance. The numbers sound great – "Our market is four hundred gazillion dollars … providing we sell one unit to every man, woman, child, hermaphrodite and dog."

You do need to estimate your total market, as it helps both in narrowing down the other market definitions, and in granting perspective on your addressable market. Defining the total market size is the easiest of exercises. If you can estimate what percentage of the population wants your product at the price you intend to charge, and if your product is new and lacks competition, then the math is quite easy:

(target population * percent buyers) * price

But it is never really that easy.

Alternately, some analyst firms may already have estimated the annual spend for your product category, and thus can provide your top-line number. However, if a market is mature enough that analyst groups have an accurate reading on total annual spend, odds are it is not a market you want to enter. Mature markets have gorillas who eat start-ups and spit out the bones.

Odds are you need to estimate your own total market because you have something relatively new and innovative. Don't sweat it as nobody uses this number for anything more than having perspective about how tiny your addressable markets are.

Addressable market

Addressable markets are (surprise) those that you can address, meaning the ones that you have an actual chance of selling. This subset of the total market includes all buyers for whom you have a reasonably whole product solution, bounded by numerous constraints. If your product can adequately serve multiple segments, then your addressable market might be as large as the sum of the segments.

But it rarely is. Constraints that would cause you to recalculate include:

- Is your product substantially weaker than competing products in a segment? If so, prorate for the segment.
- Is your product localized for all foreign markets? If not then scratch major geographic areas off the list.
- Is the adoption life-cycle so early or so late that the mass-market buyers are either not ready to buy or already have? If so, scale back the numbers.
- Does your product amplify the Market Disciplines of all customers? Highly unlikely, so you'll need to trim away buyers driven by one or more of the four disciplines (yes, four … we added one).
- Can you afford to sell into all regions? If you vend high-budget, high-context products, but do not have the budget to open an office in Brazil, then you won't need to brush up on your Portuguese.
- Lastly, have you reviewed Andrew Grove's six forces to see where market pressure will squeeze you? These six forces can squeeze a company like an anaconda with an attitude.

Realistic market

I trust you are now sufficiently confused and depressed about how to whittle your gloriously large total market into a relatively puny addressable market. If not, know that you cannot sell to your addressable market, but need to look at the smaller realistic market.

Realistic markets are just that – the market you can realistically recruit given internal constraints. If your company has two sales people and annual revenues that wouldn't be a rounding error for Hewlett Packard, then you face some significant limitations in the number of customers you can reach. Having an addressable market of a million buyers is meaningless if you have a budget that can reach ten.

Calculating your realistic market is easier than your addressable market because the number of variables is smaller and the numbers are very well defined. Your promotion and sales model, combined with your budget will tell you how many potential buyers you can reach every month. If you have been selling for any time at all, you also know your win/loss ratios. The math is very simple from there.

Here is the investor secret: If your calculations on your realistic market are sound, and you can explain how investment money will scale your market outreach, then investors will generally believe your projections. If you present the other way around, by saying you need money to sell to your addressable market, they will send you home because there is no proof of results.

Segment markets

As you know (and if you don't you have bigger problems than measuring your market), segments are essential to marketing. You have to create a whole product to attract buyers, but creating a whole product for a whole market is impossible. Thus, a segment is a 'market', and a collection of closely related segments may be a larger scale market.

Segment markets do not need belaboring except to note that often a realistic market is a subset of a segment market or cluster of closely related segments. If you show investors that you understand the segments in play, that you have a whole product for one or more of those segments, and that you have the ability to sell to realistic subsets of those segments, you will obtain investor buy-in, metaphorically and financially.

Life-cycle markets

Nobody can jump the Chasm, in either direction. I won't bother to recap the wisdom of Chasm theory that details technology market life-cycles. If you have not read the books, we'll be happy to coach you.

The lessons therein show that your opportunities are limited by the maturity of your market. In the very earliest phases, your realistic market stops before the Chasm. Telling investors that your innovator-ready product has a bazillion buyers will earn you a snug-fitting jacket with extra-long sleeves. Likewise, if the market has matured to the point where only luddites are left, convincing investors to fund your also-ran entry is absurd.

Our recommendation is simple: Look at the Chasm curve and estimate where your market is on the maturity continuum. If you are well in front of the Chasm, then your current addressable market at best includes innovators and early adopters. If your market is leaping the Chasm, then your addressable market is the early majority. If the market has already moved past the Chasm, then odds are your addressable market is the late majority with some possible conversions of the early majority.

Stated more simply, your addressable market is restricted by the maturity of the market itself, and you must abridge your appraisals.

The Steps in Measuring

How then does the struggling start-up define its market? There are two approaches:

> **Reduction:** Take each market and put constraints on it to learn what the next smaller market is. For example, start with the total market and add constraints to discover the addressable market, then do the same to the addressable market to find the realistic market. This is the least advised approach.
>
> **Build-up:** Start with your business plan, track record and current budgets and project your short- and mid-term realistic markets. This is the right approach for start-ups.

Smart companies do it from the bottom-up, supported by real numbers culled from reliable sources to build the definition. Quality numbers can come from surveys, studies, analyst reports, sales records and other sources. Let's use a fictitious company as an example.

Wally's Wonderful Widgets in Western Wallis (www.www.ww) makes blue widgets. Since blue widgets are cheap (about a penny in the local currency), Wally thinks everybody on the planet is a potential customer, though nobody will ever need two and the replacement rate is zero (once you go blue, that will do). With approximately 6,816,300,000 people roaming the earth, the total market then is about $6,816,300.

But Wally isn't nearly the sap that his competitor, Garry of Garry's Green Gizmos, thinks. Wally does not have the budget to localize the product (only supported language is Wallisian), so his market is currently constrained to the 10,000 inhabitants of Western Wallis. That means Wally has an addressable market of 10,000 people until he gets cash to localize the product.

In his first year, Wally was able to sell 100 blue widgets in Western Wallis through impulse purchase points near the cash registers at Best Buys (right next to the rewritable CDs and candy bars). This is his proven track record. By adding both the Radio Shack stores in Western Wallis (continuing with his business plan) he can reach twice as many daily buyers, so Wally expects to sell 300 widgets the next year. This one-year cash flow will allow him to localize the product for neighboring Eastern Escambia, which has twice the population but half the per capita retail electronics stores. Thus the following year Wally could sell a maximum of 600 widgets.

Needless to say – though I'll say it anyway – there are many more variables in the bottom-up market definition. But this silly sample shows the process: Develop reasonable measures of traction based on your organizational and market limits, then project forward.

So Sorry …

Like life, if measuring markets were easy then anyone could do it. Don't let the daunting scope of the problem scare you. Just understand that being realistic requires facing reality. It is better to know your markets, your abilities and your reach well before making outlandish plans. You can fool yourself with big numbers, but you likely can't fool an investor.

Guy Smith heads Silicon Strategies Marketing, a marketing consultancy devoted to helping high-technology vendors dominate their markets. He has consulted with technology firms in such diverse fields as high-availability software, interactive television, wireless messaging middleware, pure e-commerce plays, and Collaborative Software Development suites. Smith focuses on guiding his clients through the rigors of developing precise market strategies and educating his clients on both the theory and tactical necessities of their strategic implementations. His marketing expertise is matched by more that 20 years as a technologist specializing in high-availability IT processing.