

MARKET ANALYSIS

CHART IT BEFORE YOU START IT!



“

If you plan to profit, learn to please.
— Sir Winston Churchill

”

What's This Session All About?

Before starting your business, you need to understand as much as possible about the market in which you'll be selling. Who will be buying your product? Who's already offering products like yours? How can you make your product better and different, so that customers will choose you over your competitors?

Markets are affected by economic conditions, the quantity and quality of com-

petitors, consumer trends, government regulations, trade barriers and agreements (like NAFTA), and demographic changes. Understanding your customers and market conditions helps you to avoid obstacles and take advantage of opportunities.

In this session, we'll look at the following topics:

Introduction to marketing. Marketing describes everything your business does

to get its products to customers and earn a profit. It includes creating a business concept, choosing a target customer, and deciding where and at what price you will sell your product.

Expanding your market research. You started your market research in Sessions 2, 3, and 4. Now, you'll look in greater detail at your customers and markets.

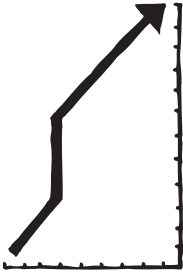
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Product description. Understanding what you're really selling is a central part of marketing. Suppose your product is cosmetics. Are you selling powder and lipstick? Or are you selling the concepts of beauty, self-esteem, and looking your best?

Understanding your market. Before you can analyze your market, you must gather market research. Who will buy your product? Where do they live, and what do they like? How many of them are there in your town, your state, and the world? In this section, we'll also look at competitive analysis, which will help you to market your product differently from your competitors.

Introduction to Marketing

A market consists of actual or possible buyers of a product, and the sellers who compete to meet these buyers' needs. Businesses can target mass markets composed of many people with broadly similar needs (as do Wal-Mart, Nike, and AT&T), or niche markets composed of fewer customers with specific, very similar needs.

Many successful microbusinesses occupy niche markets. For one thing, it's easier and takes less money to start a business in a niche market. Also, there tends to be less competition. Larger companies usually prefer to cater to the mass market, and may be less interested in targeting niche markets. And even in cases where large businesses *do* target niche markets, smaller businesses often have a powerful advantage, because they can compete on the basis of personalized customer service and greater flexibility.

Marketing includes the actions you take while designing your product, and manufacturing it, and promoting it, and selling it, and delivering it, and servicing it.

In other words, marketing is everything you do that affects the customers in your market! From a marketing perspective, *no* detail is insignificant; anything that affects the customer affects the company. (We'll discuss this in greater detail later, in our section on building a brand identity.)

Every business needs some method of marketing in order to succeed. It doesn't have to be as big and expensive as radio or television advertising, either. It can be as simple as promoting your work at local street fairs, or offering rewards to customers who send business your way.

Types of Marketing

The most familiar type of marketing is **consumer products marketing**. It includes designing colorful, eye-catching labels; choosing the best radio station to air a catchy commercial jingle; or fighting to get space in a grocery store for a "new and improved" laundry detergent.

Business-to-business marketing usually means selling parts or materials, or contracting services, to other businesses, which use them to make a finished product. Business-to-business marketing has a larger annual sales volume than that of consumer products.

One of the fastest-growing sectors of the U.S. economy is **service marketing**, which involves the sale of services like babysitting, gardening, and cleaning. You can market services to individuals or businesses.

The NxLevel® Micro-Entrepreneur Marketing Plan

This section of the NxLevel® Micro-Entrepreneur Business Plan describes your marketing objectives, strategies, and tactics.

As you may recall from Session 4:

- **Objectives** are your business's goals within chosen markets.

- **Strategies** are your plans for achieving your objectives. Strategies guide each element of the **marketing mix**, which is also known as the **Four Ps**: product, price, promotion, and placement. The goal of a marketing strategy is to find the ideal balance of these elements.
- **Tactics** are the actions you take to carry out your strategies.

The worksheets in this session will walk you through the steps of creating a marketing plan that answers the following questions:

- What does your business want to accomplish, expressed as specific objectives?
- How will you position your business in the market?
- What is your marketing niche?
- What is your business's marketing mix (product, price, promotion, placement)?
- In which geographic areas will you sell?
- What product or service enhancements will you offer?
- What financial and human resources will you require?
- What is your timeframe for achieving specific goals?
- What is your schedule and budget for specific marketing tactics?
- What level of sales do you forecast over the next 12 months?

A good marketing plan takes a lot of work, and may require several revisions.

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We didn't know what to do when the plant closed down. Like most people in town, it hit us hard. Most of our dads had worked there, and we all

grew up believing that opportunity was going to be there for our generation, too.

But things didn't turn out that way. When the plant closed, it didn't leave us with many choices. We didn't want to move out of town. It's our home, for one thing. Our families are here. And besides that, Mike and I were both engaged to our high-school sweethearts.

A few years ago, George Starkey graduated from a small high school in upstate New York. Along with his friends Roger Bacon and Michael Maier, he started working at the Vautour furniture company, as their fathers had done before them.

A year later, Vautour closed down, and outsourced its jobs to China.

For a small, tightly knit town whose economy depended on the company, this was a disaster. Some workers got jobs in nearby cities, and ended up commuting for over an hour. Others left town in search of greener pastures. And a few—like George, Roger, and Michael—decided that the only way they could get back on their feet was to start their own businesses.

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Expanding Your Market Research

In Session 4, you learned about market research, and how to collect primary and secondary data. You also researched your industry, and completed the *Industry Analysis Worksheet*. Now, we'll continue with market research, focusing on your customers, market, and competitors.

Market research helps you decide if your business is viable. Does it look like your business will work? If not, what needs to change? Honest, ongoing market research is the single best thing that you can do for yourself, your future, and the success of your business.

Research Tips

Be aware. Keep your eyes and ears open.

Ask. Ask lots of specific questions.

Listen. Carefully listen to the answers.

Evaluate. Honestly evaluate the importance of the answers you receive.

Be open to change. Be prepared to adapt your product to the needs of your target customer.

Inexpensive Market Research Methods

- Enclose pre-stamped envelopes with mail surveys.
- Tap into the knowledge of the reference librarian at your local library.
- Talk with other business people in your area and benefit from their expertise.
- Create snappy, brief surveys for people who use the kind of products you'll provide. Look for potential customers in parks, malls, ball games, the beach, downtown, at hardware stores...wherever they may be.
- Read advertising and marketing industry magazines. They often contain valuable research findings.

In this phase of market research, you'll want to identify:

- **Customers.** Who will buy your product?
- **Niche market.** What smaller part of a larger market should you target?
- **Competitive edge.** What makes your product better than or different from those of competitors?

Before you can start researching your market, you have to be able to answer some basic questions about your business. The questions on the *Basic Information Worksheet* will help you identify areas of your business that might require market research.

Where to Find Information

As we saw in Session 4, there are many ways of gathering information, including:

- **Surveys.** Gather information by interviewing groups or individuals—by mail, in person, or on the telephone.
- **Focus groups.** Get together a group of people who would use your product, and gather feedback from them.
- **Government publications.** Some are free, others may cost a small amount. Check the library or Internet for a list.
- **Libraries.** Information from libraries is usually free, except for the cost of printing or copying documents. In some cases, you may have to pay for specialized research that you order through the library.
- **Internet.** Most libraries offer free Internet access, if you don't have it at home.
- **Educational resources.** Universities or technical schools may provide free or low-cost information.
- **Commercial research companies.** Some companies do market research for a fee. This service is usually too costly for small businesses.
- **Census banks.** These "banks" store information rather than money. To find them, check at the library, or visit <http://www.census.gov>.
- **Trade associations and publications.** Nearly every industry has an association that similar or related businesses join. These groups offer members a variety of industry information, publications, and support.

Two of the best—and easiest!—methods of research are observing and asking! When dealing with customers (or potential customers), ask them for information and opinions! Have them fill out questionnaires or service cards. If you want them to try a new product, set up a product tasting or sampling table and let them give you feedback. Do you have the best chocolate chip cookie in town? Prove it! Let them taste and tell. Observe their reactions to your products, and ask direct questions.

Creating a Survey? Try These Tips

- Keep questions short, simple, and to the point
- Make it very easy for the respondent to complete
- Use a rating scale of 1 to 5 (1 = strongly disagree; 5 = strongly agree)
- Surveys should take no longer than 5-10 minutes to complete
- Be careful not to bias the answers with your questions
- Offer respondents some reward for completing the survey (money, discounts, lottery ticket, prize)
- Say thank you!

Product Description

Why do we buy products? Because they meet basic needs like eating, safety, or shelter. We also buy products that make our lives easier, make us look or feel better, or have an image we like. We buy to influence other people, and to feel differently about ourselves.

Before you can know who'll buy your product, you have to know you're actually selling! Start-up businesses often make the mistake of thinking they're selling only the product. But what they're *really* selling are the benefits of that product. It can't be said often enough: Customers buy benefits!

Let's look at an example. Joe owns a pizza restaurant. His pizzas are made from organic ingredients. A large two-topping pizza is 14" and 10 slices (two slices more than most large pizzas) and costs less than most other large pizzas in the area. His store is open 24 hours a day, and offers 25-minute delivery anywhere in town. If they're late delivering, the pizza is free!

What are the features of Joe's pizza store? And how do those features benefit the customer?

Features	Benefits
Organic ingredients	Healthy, which appeals to health- and environment-conscious consumers
14" size and 10" slices	Customers get more for their money, which appeals to <i>all</i> consumers
Open 24 hours	Convenience, which appeals to people with busy lives and unusual schedules
25-minute delivery	Time savings, which appeals to people who are in a hurry

As you can see, Joe isn't simply selling a pizza. Instead, he's set himself apart from other pizzerias

in his town by offering features and benefits that make his product unique. If you want an extra-large organic pizza at 3 a.m., delivered within 25 minutes, you have to call Joe!

The *Features and Benefits Worksheet* will help you identify the most important benefits of your products.

Understanding Your Market

The goal of market analysis is to help you understand the environment in which you'll do business. There are three components of market analysis:

- Customer analysis
- Competitive analysis
- Market potential

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Roger and Mike and me all came from wood-working families, and we wanted to continue the tradition. We decided to start a partnership called Pine Fir Yew Furniture.

Of course, we were looking to support ourselves. But we had bigger ideas than that. Our dream

was that we'd get big enough someday to hire some of the other folks who were out of work, and maybe bring the town back to life a little bit.

That was a pretty big dream for three guys with a high-school education and no money. But it gave us a lot of motivation...the idea that we were doing it not just for ourselves, but

also for our community. It kept us going through times when we were tempted to give up.



The main thing we couldn't figure out was, how could we compete with companies like Vautour? They had cheap materials, cheap overseas labor, and the best equipment in the business. How could we go up against that?

After a lot of discussion and debate, George decided the best way to compete was not to compete head-on. Where Vautour's line was mass-produced, Pine Fir Yew's would be handcrafted. Where Vautour's wood was from clearcut forests, Pine Fir Yew's would be reclaimed or recycled. Where Vautour targeted price-sensitive customers looking for the lowest price they could get, Pine Fir Yew would target businesses and consumers who made a point of buying high-quality sustainable products.

They didn't know much about marketing, but they knew that they had to find a niche market, and this looked like a promising one. In a furniture industry magazine, they'd read that sales of green furniture had totaled \$2 billion that year—a 30% increase over the previous year's sales!

They researched nontoxic stains and varnishes, underwater logging, and certification from the Forest Stewardship Council. They also looked into institutions and businesses they could target on the basis of their buying practices, and researched early American woodworking techniques.

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Customer Analysis

You can group your customers by such categories as needs, wants, motivations, and demographics. These are the clues about our customers we're looking for when we conduct market research. Let's take a look at each of these categories.

Needs

Here are some basic human needs, along with some no-frills products that might meet them:

- Transportation (a cheap subcompact car)
- Shoes (rubber thongs)
- Nutrition (cheap fast-food burgers)

Wants

What might consumers want, beyond meeting the basic needs listed above?

- A high-performance sports car
- Top-of-the-line Nike running shoes
- A steak dinner

Motivations

Why do customers want what they want?

- **Self-image.** They believe the product will make them feel younger, more attractive, more fashionable, or more powerful.
- **Health and security.** They believe the product is better for them, either because it does something good for them, or *doesn't* do something bad *to* them. Or because they believe it will protect them in some way.
- **Rewards.** On a special occasion, they want to treat themselves, or someone else, to the very best.
- **Social concerns.** They believe the product helps people, the environment, or animals.

Demographics

What statistical information describes your target customers?

- Income level
- Age
- Occupation
- Education level
- Family status (married, single, divorced, children at home, grown children)

- Hobbies
- Own vs. Rent home
- Ethnic origin

By learning about the wants, needs, motivations, and demographics of your customers, you can begin to understand your target market. You must think clearly and carefully about these issues before you launch your business!

Part of thinking clearly means putting aside your preconceptions. Preconceptions are ideas we have about things, or people, before we learn more about them.

These ideas can affect how we react to new information. When new information doesn't fit our preconceptions, we sometimes reject it. It's often easier to go on believing what we're used to believing—or would like to believe—than to change and adapt.

If you think you know what your customers are like before you research them, you may end up trying to make the facts fit your beliefs. This is very dangerous! In most cases, market research will reveal things you didn't expect. For that reason, it's very important to keep an open mind. Your goal is not to confirm your beliefs, but to find out the truth, even if it's not what you'd like it to be. Wishful thinking often leads to unrealistic planning, and unrealistic planning often leads to failure.

Customer expectations

Once you've narrowed your focus to the most promising target market, there's one more important clue to look at: What do your customers expect from you and your product?

When thinking about this question, remember that your end user may not be the person who buys your products. Suppose you make cookie dough to sell to a bakery. The bakery sells the baked cookies to a restaurant. Then, the restaurant sells them to its customers. You have to think about the

needs, wants, and expectations of each link in this chain! Your cookie dough must satisfy the bakers, the restaurant, and the restaurant's customers. If it doesn't meet the standards of any one of these customers, this will affect your bottom line.

As we mentioned earlier, one of the simplest and most direct research methods is surveying:

- If you have something to eat, ask people to taste it.
- If you have a service, ask people to try it.
- If you have something to wear, ask people to try it on.
- If you have something to sit on, ask people to sit down on it.

After they've experienced your product in use, ask them what they think. Ask for honest comments, and listen to what they say. If someone loves it, ask why. Then, ask them more questions about themselves. These are your true target customers.

If someone hates it, ask why. Don't be defensive! (Remember, you're looking for honest feedback.) Then, try to get enough information about the person to decide if you should change your product to meet his or her needs. If you make strawberry jam, and the person hates strawberries, you don't need to take his or her opinion to heart.

But if the person absolutely *loves* strawberry jam, and says "That was the worst strawberry jam I've ever had," you may have a problem! And if you hear this again and again from people who love strawberry jam, you *definitely* have a problem!

Remember to ask questions that won't simply get a yes or no answer. Instead of asking "Did you like this jam?", ask questions like "What did you think about this jam? What did you like best—and least—about it?" The idea is to get as much information as you can from as few questions as possible. Keep in mind that you aren't selling your product here. Ask unbiased questions, so that you won't influence respondents with a sales pitch.



Finding your customers

Once you've identified your target customers, you need to know where to find them. You also need to know if there are enough of them out there to make your business idea viable.

Let's say you decide that high-income homeowners with children are your target customers. Do you know where they live? Do you know how many of them there are? If only thirty percent of these people are likely to buy from you, is that enough to support your business? What about twenty percent? Census data, maps, and assessor office statistics can help you to answer these questions.

Here's an example of what we're talking about. Andy Rush wanted to start a transportation company for the elderly. Through his job at the fire department, he often saw older women and men waiting for the bus after their hospital visits or doctor appointments. Sometimes they waited for hours. Andy thought he could offer these people safer, more reliable service.

After doing some research, Andy learned that there was indeed a need for this type of business. Now, he needed to figure out how to find his customers and promote his service. He didn't have a lot of money, so he knew he had to focus his efforts on a small part of the city.

Andy used census data to identify parts of the city where a lot of elderly people lived. He drew these areas onto a city map. Then, he circled all of the hospitals and large medical offices on the map. Last, he overlaid the city bus routes onto his map.

Common sense told him he should start by promoting his business in areas with a high percentage of elderly people, and limited bus service. He figured that if a part of the city lacked an extensive bus system, elderly people on fixed incomes would need affordable, reliable transportation.



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We decided we'd keep things simple at first, and start out with just three product lines. First off, we'd make an early American pine rocker. We'd make three sizes: two for adults, and one for kids. They'd have heavy steam-bent oak runners, and the sturdiest arms and backs we could make.

Then, I had the idea of making benches in different sizes. You could use them out on the porch, put them around the dinner table, or in a kid's room, or whatever. They had a unique design, too...two trestles that tightened with a tap on the tongue's wooden peg.

The last thing we decided to make was fireplace mantelpieces. And instead of selling those out of a warehouse or a store, we'd make them to order for each customer.

How did they decide which products to offer? By studying their industry, their customers, their competitors, and their market potential.

They were encouraged by their SBDC business advisor to do a thorough job of marketing research and analysis. They divided up the work. George liked to use the computer, so he started on industry research. Roger was pretty good on the phone, so he started calling competitors. Mike went out to do personal survey work, by conducting focus groups with potential customers.

George had his work cut out for him. The furniture industry is huge, and there were firms specializing in Modern, French provincial, Scandinavian, Asian Bamboo, English, Italian, and many other styles. The competitive situation looked hopeless!

However, George knew he could limit his focus to his company's style and manufacturing technique. At first, he concentrated on looking at trade association materials online. He was able to determine there was a hole in the market for sustainable early American furniture. In particular, he found a study that indicated an unmet demand for exactly the type of furniture they wanted to make. There

were only two companies in the United States that made this kind of furniture.

Roger phoned both competitors, and received their brochures and price lists. After looking through the literature, he discovered that neither company made rocking chairs or benches. George had been working on benches all of his life, and Mike had been in charge of Vautour's chair division. They were well equipped to compete in this market!

It was George who came up with the idea of "green" mantelpieces, which his research had shown no one else was making. While they might not sell many mantelpieces in a given year, the jobs they did do would be very profitable, and lead to good word of mouth among wealthier customers. George felt this could be a stepping-stone to other kinds of custom woodworking and remodeling jobs.

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Using what you've learned

Researching your customer groups is one of the most important information-gathering exercises you can do for your business. After gathering primary and secondary data, you should be able to answer the following questions:

- Who are your target customers?
- Where do they live?
- What are their numbers by city, county, and state?
- How much do they earn?
- What are their spending patterns?
- What do they spend annually/monthly on products like yours?
- What amount of your product do they buy annually/per sale?
- During what time of year do they buy?
- What motivates them to buy?
- What are their saving patterns?
- What's their family structure?
- What's their educational level?
- What are their leisure activities?
- What media do they read, watch, or listen to?
- Who are your best prospects?
- Should you emphasize yourself, your quality offerings, your selection, your price, or merely the existence of your business?

In Session 2, we asked you to start thinking about your customer. Look back at the *Customer Profile Worksheet* in Session 2, and see if your thoughts about your primary and secondary customers have changed since you filled it out.

In this session, you'll work on the *Individual Customer Profile Worksheet*. This will help you sort out this information for two target customer groups. (If you're selling primarily to other businesses, the *Business Customer Profile Worksheet* will help you identify your primary business customers.)

Competitive Analysis

There are two types of competition: **direct competition** and **indirect competition**.

The difference is easy to explain. Suppose you sell cookies. Your most obvious direct competition would be other people who make cookies. That could mean other microbusinesses like yours, or larger businesses like bakeries.

But it doesn't stop there. You also face direct competition from stores that sell factory-made cookies, like supermarkets and convenience stores. There may also be online or mail-order businesses that sell cookies through the mail. You might make a specialty cookie, like a Danish butter cookie. But thanks to the Internet, you may be competing with

Remember to use common sense when you collect data:

- Use reliable sources
- Check and recheck the facts
- Not everything in print is true
- Not everything on the Internet is true
- Confirm your findings with other sources, if you can
- Try to get local research data, not just national statistics

cookie companies actually located in Denmark!

When you look at indirect competition, things get more complicated. In the case of cookies, you need to think about things people might eat *instead* of cookies, like brownies, chocolate bars, or ice cream. Each of those products competes with yours for the attention of people who are looking for sweets.

As we hinted above, it's very important to look at competitors on the Internet when you're thinking about direct and indirect competition. Just as the Internet allows you to compete in markets across America and around the world, it allows competitors from across America and around the world to compete in *your* market! You'll need to consider whether this affects your business, and if so, how.

What should you know about your competition?

Once you know who your competitors are, it isn't enough to assume or make judgments about them. Just as with customers, it's dangerous to rely on preconceptions about your competitors!

In order to compete effectively, you must know who and what you're competing against. Remember to look not just at products, but also at features and benefits. You and a competitor may be selling the same product, but with very different features and benefits!

Here are a few of the factors you need to look at when researching competitors:

- **Customers.** Who are their customers? You can't simply assume that they're the same as yours! Two companies selling the same basic product can have very different target markets.
- **Product.** What do they *really* sell? What features and benefits make their product unique? What's their niche?

- **Price.** Are their prices in line with customer expectations and values?
- **Placement.** How do they deliver the product to the customer? Where do they sell, and how?
- **Promotion.** What type of promotions do they run? In what media, and to what audience? Do they seem to be effective?
- **Location.** Where are your competitors located? Is it convenient for their customers? Can you offer greater convenience?
- **Company image.** What's their reputation? Do they have lots of goodwill, or are people looking for an alternative?
- **Weaknesses and strengths.** What things do they do best? In what ways are they weak?

On the *Competitive Analysis Worksheet*, you'll be asked to name three of your direct competitors, and rate them on some of these factors as you think their customers would rate them. This is the key to thinking about your business versus your competitor's business: **think like a customer!**

Time to compete!

Ben and Jerry's ice cream costs three times as much as Smith's brand ice cream. How can they get away with that? Isn't one ice cream just like the next?

Not at all! Ben and Jerry's has looked at their competition, and picked out a special niche for their ice cream. Because they know their niche, they can price their product higher than the competition. But first, they had to identify their competitive edge. For example:

- Their research indicates people think their ice cream tastes better than other brands; therefore, they can charge more.
- They advertise the use of natural products; therefore, they can claim to be healthier.

- Their ice cream is “premium specialty” ice cream, so it can be priced higher.
- They have unique flavors, for which customers will pay more.

Ben and Jerry’s has also researched their customers, and determined that their target customers are:

- Middle- to upper-income people who can afford higher prices.
- People who like high-quality or natural products, and will therefore pay a higher price.
- People who want unusual flavors that they can’t find anywhere else.

Accordingly, they designed their products to fit that target market. This clearly differentiated them from their competitors, and was a huge factor in their success.

Studying your competition can help you think of many different ways to compete, and not just based on price. What can you do better or differently than your competition? What will make your business stand out from the competition?

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Roger had been doing focus groups all this time, and he was learning some really interesting things about green furniture customers. We’d assumed that they were mostly people in big cities, with lots of money to spend. Yuppies, I guess you’d call them.

That was true, up to a point. But it wasn’t the whole story. There were a lot of people who wouldn’t call themselves “green,” but give them a choice between a green early American rocker and a regular one, and they’d buy the green one every time. As our SBDC counselor said, part of that came from people following the lead of the trendsetters. But also, for the kind of old-fashioned furniture we were making, there was this sense that we were more authentic—people felt that our furniture was more like the furniture of 150 years

ago. They liked that, and they’d pay a little more for it.

And there was also a sense that if we were concerned about how we harvested our wood and how we stained it, that this carried over into our overall workmanship. When Roger started doing surveys, we expected people to say that to them, “green” meant healthy, or natural, or safe, or things like that.

But we found out that there was this whole other response having to do with business values. He’d get words like “well-made,” “sturdy,” and “honest.” People seemed to think that taking care in one part of your business meant you were more likely to take care in other parts. This was really exciting news for us, and totally unexpected!

By studying their two competitors, George and Mike were able to discover many things about their pricing, image, and promotions. They agreed that their products would not necessarily compete with, but would dovetail nicely with their two competitors.

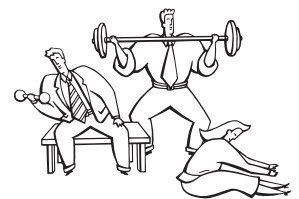
Last, they looked at their market potential, to determine if there were enough customers out there to keep them afloat. They looked at each product line separately, and found that the rockers and benches were definitely viable. It was a little harder to assess the market potential for green mantelpieces. But on the other hand, they had no competitors, and they felt it wouldn’t hurt to offer it. After all, it was a special-order item, and they could make it with existing tools and supplies.

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Market Potential

You’ve identified your target customers, and your direct and indirect competitors. Now, it’s time to try to figure out if there are enough of your target customers to support your business. This is called **market potential**.

Several factors affect your market potential. Are



there enough customers in your geographic area to support your business? First, this depends on the total population of your area. Second, it depends on how much of the population fits your customer profile. Last, it depends on your competition in the area. How many competitors do you have, and how good are they at what they do?

Such things as general economic conditions, population growth or decline in the area, and geographic income levels may also influence your market potential.

Discover Your Market Potential!

Step 1. Estimate how many potential customers you have.

Step 2. Estimate how much they spend on your type of product in an average year.

Step 3. Multiply the number of potential customers by the average amount they spend each year. This will determine your total market potential.

Once you know your total market potential, the next step is to figure out how many of those potential customers will choose your business. To do this, you must consider both the direct and indirect competition for your business. How many people will buy from you, rather than from the competition?

Let's look at how one entrepreneur figured out his market potential.

John wants to open a bicycle and skateboard shop in a community of 50,000 people. He's determined that about 1,000 people in the community are potential customers, and that they replace their equipment every three years, on average. The average cost for replacement equipment is about \$300 per person. Therefore, it looks as though John will sell about \$300,000 worth of equipment over three years (1000 people x \$300 per person).

Not everybody buys new equipment at the same time, so John predicts that his community will spend about \$100,000 per year on his product. In other words, he's assuming that a third of his potential customers will need to replace their equipment each year.

There's one other bike and skate shop in town, and they have gross sales of about \$75,000 per year. They carry only a few brands, and have very few accessories. John anticipates that the other \$25,000 of sales goes either to the Internet businesses, or to other out-of-town retailers.

What's John's market potential? He thinks he can lure about half of the existing business away from the other local shop by offering more selection, competitive prices, and more accessories. Based on that assumption, he thinks his market potential is at least \$37,500 (half of \$75,000).

His industry information told him that he should be able to sell an additional 30% in accessories. That gives him another \$11,250 in accessory sales, for a total of \$48,750 in retail sales (\$37,500 + \$11,250.)

John's inventory will cost \$24,375 (half of the retail price). Rent on his building will cost \$1,000 per month, which equals \$12,000 per year. Also, John must be able to take out \$1,500 per month in salary for himself, which comes to \$18,000 per year.

Looking at these very basic costs, is there enough market potential for John to consider this business? Let's find out.

Inventory	\$24,375
Rent	12,000
John's salary	<u>18,000</u>
Basic costs	\$54,375
Anticipated sales	48,750
Basic costs	<u>\$54,375</u>
Shortfall	(\$5,625)

John hasn't yet looked at the other costs necessary to run his business, but he already knows that he doesn't have the market potential to cover his basic costs. As you can imagine, he's very glad to find this out *before* putting a deposit on a rental space, or buying inventory!

We'll use the *Market Potential Worksheet* to figure out a projected annual sales volume for your business, so don't worry about understanding the formula right now. The main concept to understand here is that it's very important to learn everything you can about your customers and competitors. Once you know that, you can figure out your market potential.

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By the end of our first year, we were selling a good amount of furniture to individuals...benches mostly, with the kid-sized rockers in second place. But we also got calls from a couple of bed-and-breakfasts that wanted a full line of matching furniture, which was a market we'd never thought of looking into. It was good timing, because we were realizing that we'd never be able to grow enough to hire folks from Vautour with just three types of furniture in our product line.

We'd just started working on a new round of market research...trying to figure out what the market potential was for some new product lines. It was a lot trickier this time, because we'd be dealing with a lot more direct competition if we made things like tables and bedframes.

Then we met Barbara, and everything changed pretty much overnight.

One day, a young designer named Barbara Comyns happened to stop by Pine Fir Yew's workshop. She'd owned one of their rocking chairs, and was interested in seeing how their furniture was made.

While talking to Mike and Roger, she explained her idea for a set of standardized wooden components that would fit together in a variety of ways to form end tables, dining

tables, chairs, desks, and day beds. There was no glue, and no nails or screws. It was an amazing idea! She'd gotten the idea from watching her nephew playing with Tinker toys, and wanted to find a small company who'd handcraft the parts under her supervision.

Roger saw instantly that if her design really worked, it would be ideal both for institutional and consumer use. He thought they should go for it.

George was more cautious, though. So far, their two competitors in early American green furniture had decided not to produce any of the same products Pine Fir Yew did. But if Pine Fir Yew decided to take on Barbara's product line extension, they'd be in direct competition with the two other green manufacturers.

Roger and Mike saw his point. They decided to go back to the beginning, and start yet another marketing research project. They needed to identify their customers for the new product line, and define their market potential. They needed to come up with appropriate pricing. And most important, they had to make sure they could find and maintain a competitive edge.

Their research suggested that the novelty of Barbara's designs gave them an edge over their competitors, and decided to move forward. They negotiated a licensing deal with Barbara, updated their business plan, and started producing the interlocking pieces according to her design.

Today, they produce a limited amount of handmade furniture for the high-end market, and hundreds of building blocks for Barbara's popular modular furniture (the local elementary school loves it!). They now have eighteen full-time employees, and three part-timers. They're still dreaming of building a factory that'll employ a hundred workers or more.



Part of our success has been skill...we're good at what we do. And part of it has been luck, for sure. But I think the single biggest factor in our success is that we learned early on to study our market, and make sure the potential for long-term profit was there. You can make a quality product, and have no competition from anyone. But if the market's not there, you won't succeed. So to me, the most important thing we learned from our SBDC counselor was to look before you leap.

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What You've Learned

This session was designed to help you start developing your marketing plan. The first step in marketing is understanding what you sell. Good marketers define the features and benefits of their products, because they know that customers buy benefits!

Once you've figured out what you sell, then you can think about the people you'll sell to (your customers), and who else sells the same thing, or a similar thing (your competition).

You also learned to expand your market research to include customer analysis, competitive analysis, and market potential. Let's quickly recap the essential steps to market research:

1. Determine your customer profile. This is critical to figuring out your target market. Don't be afraid to use all methods of research when determining your customer, including observation and surveying.

2. Study the competition. Identify your direct, indirect, and future competition. Research them, looking for competitive factors that you can use to your advantage. What does your competition do well? What could you possibly do better? What is your niche, given the existing competition?
3. Calculate your market potential. Given your customer profile and the existing competition, is there a market for your product or service?

Understanding market research and analysis gives you an advantage over most start-up businesses. Successful entrepreneurs know that ongoing market research and analysis keeps them from making bad judgments based on outdated information or wishful thinking.