**How to do a market analysis for a business plan**

**How to do a market analysis?**

The objectives of the market analysis section of a business plan are to show to investors that:

you know your market

the market is large enough to build a sustainable business

In order to do that I recommend the following plan:

Demographics and Segmentation

Target Market

Market Need

Competition

Barriers to Entry

Regulation

The first step of the analysis consists in assessing the size of the market.

**Demographics and Segmentation**

When assessing the size of the market, your approach will depend on the type of business you are selling to investors. If your business plan is for a small shop or a restaurant then you need to take a local approach and try to assess the market around your shop. If you are writing a business plan for a restaurant chain then you need to assess the market a national level.

Depending on your market you might also want to slice it into different segments. This is especially relevant if you or your competitors focus only on certain segments.

**Volume & Value**

There are two factors you need to look at when assessing the size of a market: the number of potential customers and the value of the market. It is very important to look at both numbers separately, let's take an example to understand why.

Imagine that you have the opportunity to open a shop either in Town A or in Town B:

Town A B

Market value £200m £100m

Potential customers 2 big companies 1,000 small companies

Competition 2 competitors 10 competitors

Table: Town A vs. Town B

Although Town B looks more competitive (10 competitors vs. 2 in Town A) and a smaller opportunity (market size of £100m vs. £200 in Town A), with 1,000 potential customers it is actually a more accessible market than Town A where you have only 2 potential customers.

Potential customer?

The definition of a potential customer will depend on your type of business. For example if you are opening a small shop selling office furniture then your market will be all the companies within your delivery range. As in the example above it is likely that most companies would have only one person in charge of purchasing furniture hence you wouldn't take the size of these businesses in consideration when assessing the number of potential customers. You would however factor it when assessing the value of the market.

Market value

Estimating the market value is often more difficult than assessing the number of potential customers. The first thing to do is to see if the figure is publicly available as either published by a consultancy firm or by a state body. It is very likely that you will find at least a number on a national level.

If not then you can either buy some market research or try to estimate it yourself.

Methods for building an estimate

There are 2 methods that can be used to build estimates: the bottom up approach or the top down approach.

The bottom up approach consist in building a global number starting with unitary values. In our case the number of potential clients multiplied by an average transaction value.

Let's keep our office furniture example and try to estimate the value of the 'desk' segment. We would first factor in the size of the businesses in our delivery range in order to come up with the size of the desks park. Then we would try to estimate the renewal rate of the park to get the volume of annual transactions. Finally, we would apply an average price to the annual volume of transactions to get to the estimated market value.

Here is a summary of the steps including where to find the information:

Size of desks park = number of businesses in delivery area x number of employees (you might want to refine this number based on the sector as not all employees have desks)

Renewal rate = 1 / useful life of a desk

Volume of transactions = size of desks park x renewal rate

Value of 1 transaction = average price of a desk

Market value = volume of transactions x value of 1 transaction

You should be able to find most of the information for free in this example. You can get the number and size of businesses in your delivery area from the national statistics. Your accountant should be able to give you the useful life of a desk (but you should know it since it is your market!). You can compare the desk prices of other furniture stores in your area. As a side note here: it is always a good idea to ask your competitors for market data (just don't say you are going to compete with them).

That was the bottom up approach, now let's look into the top down approach.

The top down approach consist in starting with a global number and reducing it pro-rata. In our case we would start with the value of UK office furniture market which AMA Research estimates to be around £650m and then do a pro-rata on this number using the number of businesses in our delivery area x their number of employees / total number of people employed in the UK. Once again the number of employees would only be a rough proxy given all business don't have the same furniture requirements.

When coming up with an estimate yourself it is always a good practice to test both the bottom up and top down approaches and to compare the results. If the numbers are too far away then you probably missed something or used the wrong proxy.

Once you have estimated the market size you need to explain to your reader which segment(s) of the market you view as your target market.

Target Market

The target market is the type of customers you target within the market. For example if you are selling jewellery you can either be a generalist or decide to focus on the high end or the lower end of the market. This section is relevant when your market has clear segments with different drivers of demand. In my example of jewels, value for money would be one of the drivers of the lower end market whereas exclusivity and prestige would drive the high end.

Now it is time to focus on the more qualitative side of the market analysis by looking at what drives the demand.

Market Need

This section is very important as it is where you show your potential investor that you have an intimate knowledge of your market. You know why they buy!

Here you need to get into the details of the drivers of demand for your product or services. One way to look at what a driver is, is to look at takeaway coffee. One of the drivers for coffee is consistency. The coffee one buys in a chain is not necessarily better than the one from the independent coffee shop next door. But if you are not from the area then you don't know what the independent coffee shop's coffee is worth. Whereas you know that the coffee from the chain will taste just like in every other shop of this chain. Hence most people on the move buy coffee from chains rather than independent coffee shops.

From a tactical point of view, this section is also where you need to place your competitive edge without mentioning it explicitly. In the following sections of your business plan you are going to talk about your competition and their strengths, weaknesses and market positioning before reaching the Strategy section in which you'll explain your own market positioning. What you want to do is prepare the reader to embrace your positioning and invest in your company.

To do so you need to highlight in this section some of the drivers that your competition has not been focussing on. A quick example for an independent coffee shop surrounded by coffee chains would be to say that on top of consistency, which is relevant for people on the move, another driver for coffee shop demand is the place itself as what coffee shops sell before most is a place for people to meet. You would then present your competition. And in the Strategy section explain that you will focus on locals looking for a place to meet rather than takeaway coffee and that your differentiating factor will be the authenticity and atmosphere of your local shop.

Competition

The aim of this section is to give a fair view of who you are competing against. You need to explain your competitors' positioning and describe their strengths and weaknesses. You should write this part in parallel with the Competitive Edge part of the Strategy section.

The idea here is to analyse your competitors angle to the market in order to find a weakness that your company will be able to use in its own market positioning.

One way to carry the analysis is to benchmark your competitor against each of the key drivers of demand for your market (price, quality, add-on services, etc.) and present the results in a table.

Below is an example for a furniture shop in France. As you can see from the table all the actors on the market are currently focused on the low medium range of the market leaving the space free for a high end focused new player.

Company Competitor 1

(Small shop) Competitor 2

(Small shop) Competitor 3

(Chain) My Company

Revenues € 750,000 N.A. € 1,500,000 € 400,000

(year 1 target)

Nb. employees 10 5 20 5

Size 1 shop in Caen,

1 shop in Cabourg 1 shop in Caen 3 shops in Caen 1 shop in Caen

Price Low Average Average High

Quality Low Average Average Superior

Choice Large Low Very large Average

Delivery No € 50 Free from € 100 Free

Table: side by side competitive analysis

Barriers to Entry

This section is all about answering two questions from your investors:

what prevents someone from opening a shop in front of yours and take 50% of your business?

having answered the previous question what makes you think you will be successful in trying to enter this market? (start-up only)

As you would have guess barriers to entry are great. Investors love them and there is one reason for this: it protects your business from new competition!

Here are a few examples of barriers to entry:

Investment (project that require a substantial investment)

Technology (sophisticated technology a website is not one, knowing how to process uranium is)

Brand (the huge marketing costs required to get to a certain level of recognition)

Regulation (licences and concessions in particular)

Access to resources (exclusivity with suppliers, proprietary resources)

Access to distribution channels (exclusivity with distributors, proprietary network)

Location (a shop on Regent's Stree