



3. Market Analysis

Student edition

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Introduction

Effective market analysis is imperative for the development and sustainability of a business. Surveys of the market provide details on a large range of factors that affect the company, such as the environment it operates in, the competitive situation, the size of the market, the potential market share etc. An entrepreneur will use this information to determine if the industry is **accessible**. In other words, he or she must figure out whether the market is a realistic place for a new venture to enter. The entrepreneur will also use the information to identify whether the industry contains niche markets that are currently underserved, or whether they are ripe for innovation. Equipped with this information, the entrepreneur will be able to position a product or service relative to the competition.

This unit begins by discussing the concept of **market analysis** and some of the unique challenges that entrepreneurs face in this regard. The remainder of the unit focuses on specific **tools for analysing the market**. More specifically, the unit explains how to segment the market and evaluate its effectiveness; how to analyse the external environment using tools such as **PEST**, **Porter's Five Forces model** and a **competitive analysis audit**; and how to analyse the internal environment using tools such as the **SWOT** framework and the **TOWS** matrix. The unit concludes by explaining how to position a product relative to others.

Learning objectives

When you have successfully completed this unit you will be able to:

- Explain the purpose and importance of market analysis.
- Identify specific problems that entrepreneurs face regarding market analysis.
- Describe how to segment a market.
- Use appropriate tools to analyse the external environment.
- Use appropriate tools to analyse the internal environment.
- Determine how to position a product.

1. Understanding Market Analysis

Market analysis plays a major part in a venture's planning activities. It provides decision makers with detailed information regarding crucial factors that have an impact on the product and target market. In order to understand the potential market you should ask the following questions:

- Who are your potential customers?
- How many potential customers are there?
- What type of products or services would be profitable to introduce in the market?
- Would potential customers use your product/service? If so why or not why not?
- Is the company able to satisfy customer needs, wants and expectations?
- Why do potential customers not purchase your product/service at present?
- How do these customers respond to marketing approaches?
- Should any changes be made to the packaging, delivery or the product itself?

The answers to these questions will guide decisions on many aspects of the company. It will also help decision makers to formulate a viable marketing plan.

3. Market Analysis

However, market analysis can be a complex, intricate and expensive process and entrepreneurs typically face many problems in this regard.

According to Kaplan and Warren (2007) entrepreneurs face different challenges than those in established companies. For example:

Limited Resources

They have limited resources. They rarely have enough money to enable extensive market analysis surveys and they do not normally have proven marketing experience within the firm. Furthermore, many do not have the option of hiring experienced marketing managers. Time is also in short supply for start-up companies. Consequently, entrepreneurs must find creative and cheaper means to test and validate their ideas.

Limited Geographic Market Presence

Start-ups by their nature do not have any market share. They also have a limited geographic market presence. As a result they cannot take advantage of economies of scale. Entrepreneurs are also restricted in their access to distributors. Furthermore, as they are just entering the market place they suffer from low brand awareness and poor customer loyalty

Limited Market Information

Market information is limited and decision making can be clouded by strong personal biases and beliefs. Research suggests that the most common marketing problems relate to overestimating demand, underestimating competitor response and making poor distribution decisions.

Lot of Ground Work

Entrepreneurs have a lot of ground-work to do. They must target, position and sell themselves to many audiences, namely customers, employees, distributors, investors and business partners.

3. Market Analysis

In order to analyse the market, there are several things the entrepreneur must do. Figure 3.1 illustrates the process involved. The key stages are:

- 1 Segment the market and evaluate its effectiveness
- 2 Analyse the external environment
- 3 Analyse the internal environment
- 4 Position the Product

The remainder of this unit deals with each of these activities in more detail.

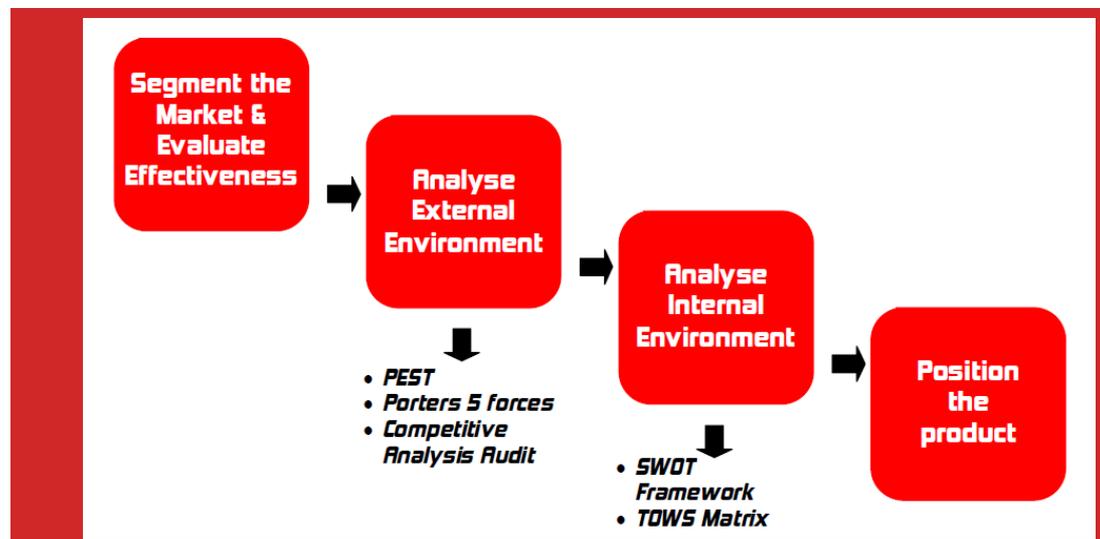


Figure 1: Market Analysis Process

2. Market Segmentation

Market segmentation is the identification of sections of the market that are different from one another. The process helps to establish the profile or details about customers in order to identify the most valuable ones.

The purpose of segmenting a market is to concentrate on the subset of potential customers that are 'most likely' to purchase your product or service.

This will help to better satisfy the needs of potential customers and ensure the highest return for investment. There are several ways to segment a market.

Demographic segmentation

Demographic segmentation divides the market into groups, based on age, gender, family size, occupation, income level, nationality, religion and social class.

Geographic segmentation

Geographic segmentation divides people or businesses into regions (continent, country, neighbourhood), size of the population, population density and climate.

Psychographic segmentation

Psychographic segmentation divides into cultural groups, value or social categories such as activities, interests, opinions, attitudes and values.

Behaviouralistic segmentation

Behaviouralistic segmentation divides by actual customer behaviour towards the product such as benefits sought, usage rate, brand loyalty and readiness to buy.

3. Market Analysis

In order to assess whether or not you have adopted the right approach to market segmentation, you should evaluate its effectiveness. To do this, you should assess if the target market is:

1

Identifiable

*Can you allocate the customers to a particular segment?
Can you measure the different attributes of the segment?*

2

Accessible

*Can you reach the segment in a cost-effective manner?
Can you access the segment through distribution channels?*

3

Substantial:

*Is the segment large enough to be profitable?
Does it justify the resources needed to target it?*

4

Possesses unique needs:

*Do potential customer groups have different needs?
Are separate product offerings justified?*

5

Durable

*Are the segments relatively stable?
Are customers in the segments both willing and able to pay?*

Once the company has found its specific segment of the market, it can investigate the influences on the decision to purchase the product. Depending on your product/service you may have to be very price-competitive to break into the market, especially if there are well-established companies already operating there. If your product is similar to that of another company, then **price** is possibly one of the deciding factors when buying your product. If your company has something unique about its product/service or the company set-up, then you should really promote this.

Once you have an idea of the market that you are interested in, you can proceed to a more detailed market analysis. You can do this by conducting an **external analysis** which examines the environment, the industry and the competition. You can then examine the **internal operating environment** of the organisation. The next and final step is to **position your product** relative to others in order to target your customers.

3. External Analysis

In order to have a better understanding of the environment you intend to operate in, it is good practice to systematically analyse all external influences that affect the company's decisions and performance. In order to avoid creating too much information, you should distinguish the vital from the merely important.

Some of the most popular tools for external analysis are PEST, Porter's five forces model and competitive analyses.

3.1 Environmental analysis: PEST

In order to better understand the context in which a business operates, you should undertake an analysis of the operating environment.

You can analyse the key forces in operation in the macro environment using a PEST analysis. This provides a framework for discussion under the headings political/legal, economic, socio-cultural, technological and legal.

Table 1 provides an example of a PEST analysis. This example captures and documents details of the Dublin market for pubs.

3. Market Analysis

Political	<ul style="list-style-type: none"> • Political stability • Influence of government policies that control the business. • Government directions regarding market ethics, and consumer protection • Government economic policies. • Influence of government on religion and culture • Involvement of government in trade agreements • Laws of employment 	<p><i>What permits do you need to open a pub in Dublin?</i></p> <p><i>What are regulations for employing staff?</i></p>
Economic	<ul style="list-style-type: none"> • Rate of interest • State of inflation • Per capita income • Gross Domestic Product (GDP) • Economic progress trend • Rate of exchange • Consumer confidence and its affect on aggregate demand • Production level 	<p><i>To people want / need another pub in Dublin?</i></p> <p><i>Is the consumer confidence increasing or decreasing? If you compare it to last year: are there still as many people buying a beer in a pub?</i></p> <p><i>Is the per capita income increasing or decreasing in Dublin?</i></p>
Social	<ul style="list-style-type: none"> • Leading religion • Attitude towards foreign goods and services • Influence of language on use of products in the markets • Time available with the consumers for leisure • Role of women and men in the society • Opinion of people on green issues • Demographics of the population • Lifestyle, education, health, fashion trends, earning capacity 	<p><i>Who tend to go to pubs more often: men or women (or no difference)?</i></p> <p><i>Is sustainability important for people living in Dublin? Or for tourist? What are trends in the Hospitality industry?</i></p> <p><i>Are there more older or more younger people living in Dublin?</i></p>
Technological	<ul style="list-style-type: none"> • R&D activity • Automation • Technology incentives • Rate of technological change 	<p><i>Can certain staff tasks be automated?</i></p> <p><i>Is a solid internet connection available?</i></p>

Table 1: PEST Analysis of the Dublin market for pubs (Fennelly and Cormican 2006)

3.2 Industry Analysis: Porters five forces model

Having looked at the general macro environment, it is time to turn your attention to the competitive environment in which the company operates. According to Michael Porter (1980), the state of competition in an industry depends on five forces. Figure 2 illustrates these. The section below discusses them in more detail.

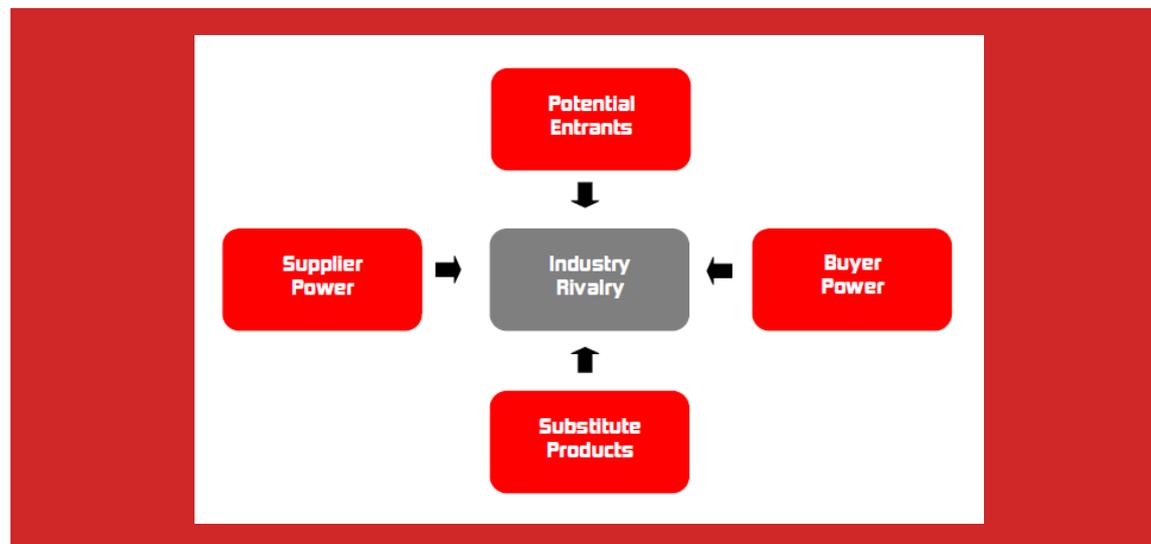


Figure 2: Porters five forces model (Porter 1980)

The risk of new and potential competitors

Effectively, this refers to the barriers to entry. These incorporate factors that make it harder or easier for another company to enter into the industry. They may include proprietary product differences, brand identity, the cost of switching, capital requirements etc.

Supplier power

This refers to the bargaining power of suppliers. Factors that influence the amount of power suppliers have include the switching costs of suppliers, the presence of substitute inputs and supplier concentration.

The threat of substitute products: Factors that affect the risk of an alternative entering the market include the relative price performance of substitutes, switching costs and the buyer's propensity to substitute.

Buyer power: This refers to the bargaining power of buyers. Factors that affect the influence of buyers include buyer concentration versus supplier concentration, buyer information, buyer volume, substitute products, price sensitivity, product differences etc.

Industry rivalry: This refers to the degree of competition among established companies within an industry. Factors to consider here include industry growth, product differences, brand identity, switching costs and exit barriers.

3. Market Analysis

3.3 Competitive analysis: audit

It is particularly important for leaders of new ventures to identify which businesses will provide the most significant competition. It is important to attempt to predict what key competitors are most likely to do.

Entrepreneurs can understand and analyse the situation by asking the questions provided below regarding six key areas of competition (see table 2).

Products & Services	<i>How is the competitive product or service defined? How is it similar or different? Does the competition cater to a mass or targeted market? What features of the product are superior? What strengths or weaknesses of the competition can be exploited?</i>
Price	<i>What is the competitor's pricing strategy? Is the competitor's price higher or lower? What is the competitor's gross margin for similar products? Does the competitor offer terms, discounts, or promotions?</i>
Industry Competitors	<i>Define the competition in terms of new or potential threats of existing companies. What are the strengths and weaknesses of each? How will e-commerce companies affect the business? How can the suppliers or buyers affect the competition?</i>
Selling Promotion	<i>How do the competitors advertise? What are the strengths and weaknesses of each? Will e-advertising affect the business? How can the suppliers or buyers affect the competition?</i>

3. Market Analysis

Management Team

*Define the competition in terms of new or potential threats from existing companies.
What are the strengths and weaknesses of each?
How can the suppliers or buyers affect the competition?*

Financial

*Are all competitors profitable?
What are the sales and market shares volumes?
Where do they spend their money?
Are they properly capitalised? How strong is their cash flow?*

4. Internal Analysis

The previous sections analysed the macro and industry environments within which the organisation operates. It is equally important to understand the internal operating environment of the business. Questions that all entrepreneurs should ask, but often don't, include:

- What business are we in?
- Who is our competition?
- What competitive advantages do we possess?
- What are our core skills and capabilities?
- Who are our customers?
- What are our customer needs?
- How can we meet our customer needs?

In order to help answer these questions in a systematic manner, you can use simple tools such as the SWOT framework and the TOWS matrix.

4.1 Internal analysis: SWOT analysis

The SWOT matrix provides a framework to analyse the internal factors (strengths and weaknesses) and external factors (opportunities and threats) of a company. This matrix gives an overview of the strategic position of the company at a glance.

The Strengths and Weaknesses represent the internal environment of a firm's functional and process capabilities and financial resources. They help to identify and/or create new market spaces, whilst the Opportunities and Threats build from the PEST and Porter's five forces external environment.

3. Market Analysis

The SWOT Framework (see Figure 3) helps you ask, and answer, the following questions:

- How do you make the most of your strengths?
- How do you avert your weaknesses?
- How do you exploit your opportunities?
- How do you manage your threats?

Strengths:	Weaknesses:
Opportunities:	Threats:

Figure 3: SWOT Analysis Framework

4.2 TOWS matrix

You can invert the SWOT analysis to construct a TOWS matrix (Wehrich 1982), suggesting strategy options that might benefit the company in the short, medium and long term.

The TOWS matrix is more externally focused and helps you think about the options that you could pursue. To do this you match external opportunities and threats with your internal strengths and weaknesses, as illustrated in Figure 4.

3. Market Analysis

		Internal Elements	
		Have and Want (Strengths)	Have and Not Want (Weaknesses)
External Elements	Not Have and Want (Opportunities)	SO: Strengths can be used to capitalise or build upon existing or emerging opportunities	WO: The options developed need to overcome weaknesses if existing or emerging opportunities are to be exploited
	Not Have and Not Want (Threats)	ST: Strengths can be used to minimise existing or emerging threats	WT: The options pursued must minimise or overcome weaknesses and as far as possible cope with threats

Figure 4 TOWS Matrix (Wehrich 1982)

The TOWS matrix helps you ask, and answer, the following questions:

Strengths and Opportunities (SO)

How can you use your strengths to take advantage of these opportunities?

Strengths and Threats (ST)

How can you take advantage of your strengths to avoid real and potential threats?

Weaknesses and Opportunities (WO)

How can you use your opportunities to overcome the weaknesses you are experiencing?

Weaknesses and Threats (WT):

How can you minimise your weaknesses and avoid threats?

5. Position the Product

A critical aspect of any start-up's chance for success is how it positions itself relative to its industry rivals.

Product positioning refers to the process used by organisations to create an image or identity in the minds of a target market for its product, brand, and/or organisation.

A product's position is how potential buyers see the product. It is normally considered relative to the position of competitors. Some strategies to help position your product include:

Unique selling proposition

This refers to something unique that you have to offer. It does not necessarily have to be completely unique. It can appear unique by simply packaging your product or service in a different way.

Risk reversal:

You can differentiate yourself by using self-assured guarantees. Most people are genuinely honest, and if your service is what you say it is, you've got nothing to worry about. The increased sales volume will be well worth it.

Customer education

You can use clear, complete and concise language or text to let potential customers know exactly what you are offering. Customers should not have to figure out on their own why they should be doing business with you — you should educate them.

Pricing strategies

One way to position a product is to charge a high price when there is a low level of competition or substitution products. Another is to 'match competition' by pricing slightly under the competitor's rates to expand your own market share. A third is to substantially under-price the market, so as to exclude competitors altogether.

Review

This unit focused on market analysis for start-ups. It introduced the concept and stressed the importance of this activity. It highlighted particular challenges faced by entrepreneurs. The unit then focused on presenting simple, practical and useful tools to help analyse the market.

Key stages in market analysis are:

- segment the market and evaluate its effectiveness;
- analyse the external environment;
- analyse the internal environment and
- position the product.

Market segmentation approaches include:

- Demographic segmentation
- Geographic segmentation
- Psychographic segmentation
- Behaviouralistic segmentation

Your market must be:

- identifiable;
- accessible;
- substantial;
- possesses unique needs, and finally
- durable.

Once you have an idea of the market that you are interested in, you can proceed to a more detailed market analysis. You can do this by conducting an **external analysis** which examines the environment, the industry and the competition. You can then examine the **internal operating environment** of the organisation. Tools for external analysis include PEST and Porter's five forces. Tools for internal analysis include SWOT and TOWS. The next and final step is to **position your product** relative to others in order to target your customers.

Self-Assessment Questions

1. Why is market analysis important for new ventures?
2. List some problems that entrepreneurs face regarding market analysis.
3. Describe how to segment a market.
4. Explain how to position a product.

References

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