Market sizing

Market sizing is the act of estimating the potential of a market, including the total number of potential buyers and the total revenue they may generate.

It can be used to estimate how much profit a new product or service could make, and help those in the C-suite decide whether or not they should invest in the market.

The information you'll gain from market sizing can also help develop a unique marketing strategy and can be used to estimate the resources and manpower you'll need before you launch a new product or service.

Methods

The two most commonly used methods are **top-down** and **bottom-up**.

Top-down looks at the relevant market size for your product and calculates how much profit your company stands to earn from it. Although simple, this method can be unreliable.

Say for example your organization specializes in computer software for finance companies, your research finds that there are 5,000 relevant businesses in your country. The average sale per finance company is $40,000, so that makes your market size $200M. Providing, of course, every finance company you approach agrees to the sale and buys $40,000 worth of product.

As you can see, a wildly optimistic figure.

Bottom-up

This method is a little more time-consuming than the above, because you're relying on actual market research instead of generalized forecasts. This way you'll get a much more accurate picture of your potential market.

How to calculate market size

1. Define your target market

Use market segmentation to divide your market into specific groups to give yourself a better understanding of who your product will appeal to.

Once you've identified the different segments you think your product will appeal to, choose the ones you want to market to build your client base.

2. Determine the size of your target market

You could start this process by contacting business organizations, data providers, civic organizations or regulatory agencies, do as much research as you can to source a list of potential clients.

Example

Your company wants to develop a point of sale software for smaller, independent bars and restaurants, but before you invest money and resources, you need to make sure there is a market out there for it.

After conducting some online research and contacting your region's business and commerce department, you find there are around 20,000 independent bars and restaurants in your country and successfully source a list of all of them.

Market research

Using market research is a great way to estimate realistic interest in your product.

Assess interest by:

- Conducting individual interviews
- Focus groups
- Surveys

* Remember the bigger the sample, the better the analysis.

Ask questions like:

- Does this product interest you?
- What would you pay for this product?
- How likely are you to purchase this product in the next two years?

Example

In three months you talk to 150 small bars and restaurants, each representing 1% of your target market. You present the software and its benefits, explaining how it will solve their particular problem.

After the demo, 55 of the businesses express an interest in purchasing the software when the product is available. Let's be conservative and knock that number down to 22.

Now 22% of small bars and restaurants in your market are interested in your product. Out of 20,000 small bars & restaurants you may have around 4,400 interested in buying your product.

Tip: *Conducting this kind of research takes time, make it count by taking the opportunity to gather any other market research you might need.*

Calculate potential sales

Now you have a more realistic figure, you can use this data to decide whether your product is worth the investment.

Develop a financial model of your business

Using the data you have gathered develop a financial model of your business using:

- Cash Flow forecasting
- Net Present Value (NPV) and Internal Rate of Return (IRR)

Identify key assumptions

Identify key assumptions in your financial model and test them using:

- Scenario analysis
- Monte Carlo analysis

Example

You've determined that 4,400 small bars and restaurants might purchase your software, which cost $30,000. If every bar and restaurant in your target group made the purchase this is a return of $132M.

To make, develop, test, and market this product, your company will have to invest at least $10M. This investment is just 7.6% of the product's potential annual revenue. Even if the response isn't quite as positive as predicted, that's a low-risk investment.