

## Topic 2.2: Market Analysis

*How large is your market and what is your competition?*

A startup's growth potential depends on the size of its market and what share of the market it can acquire for itself. The market share in turn depends on the strength of the competition. Describing and estimating these factors is called *Market Analysis*.

Market Analysis is very important for investors, and it is therefore a required component of any business plan. It is also Level 2 of Steve Blank's Investment Readiness Level.

Market Analysis depends on the definitions of Customer Need (Chapter 1.1) and Target Market (Chapter 1.2).

### The Three Market Views TAM, SAM and SOM

Startup often use a model of market potential that contain three different perspectives. These are known by their abbreviations as TAM, SAM and SOM. Each of these perspectives ha a different meaning for investors.

Unfortunately, there are several different definitions and names for TAM, SAM and SOM in circulation; some of these definitions are unhelpful and others even contradict each other. Founders therefore need to take care when using these terms.

## TAM: Total Addressable Market

The *Total Addressable Market* or *Total Available Market* of a product contains the total world expenditure world for the solution that that product provides. Another way of saying this is, “what would the total sales be for this product if there were no alternatives available and the supplier could satisfy the entire demand?”

The TAM is a theoretical quantity that can never be attained in practice. It helps investors to understand the market in which a startup is active.

## SAM: Serviceable Addressable Market

The *Serviceable Addressable Market* or *Served Available Market* describes the market that the startup can, in principle, address with its offer. The SAM answers the question, “for which part of the TAM is our product appropriate?” The SAM corresponds to the Target Market from Chapter 1.2.

The SAM is derived from the TAM by eliminating the market segments that the startup cannot serve – either because they do not belong to the target market or because the startup does not have the ability to serve them.

The SAM is important for investors, because it indicates the medium-term potential of the startup to them.

## SOM: Serviceable Obtainable Market

The *Serviceable Obtainable Market* or *Share of Market* is the part of the SAM that the startup can realistically serve. The SOM answers the question, “What part of the SAM is realistic for our business model?”

The SOM is a subset of the SAM that is restricted by factors such as the following:

- Natural barriers such as distance or language
- Limited capacity, for example production capacity or marketing reach
- Loss of market share to competitors

The SOM indicates to investors what the startup must achieve so that they will not lose their money in a short period of time. For founders, the SOM is an important business goal.

## Estimating the Market Size

Market potential is given in € or \$ per year. There are two ways to arrive at an estimate:

- One has already been published, for example as a market report by a consulting firm or a government statistics office.
- It is calculated by multiplying the number of customers by the average yearly expenditure for satisfying the specific customer need per customer.

Since startups usually have innovative products for which a market does not currently exist, they must usually use the second method.

## Competitors

For the purposes of market analysis, the most useful definition of competition is, “everyone who could be paid for satisfying the need of your target market”.

Competitors divide up the market among themselves. They are one of the factors that cause the difference in size between SAM and SOM.

There are competitors who provide similar solutions and there are others who offer dissimilar ones. Both types of solution serve the same customer need. Since startups usually have innovative products, their competitors will usually have dissimilar solutions.

Of course, the competition can only be identified after the target market and customer need have been defined.

## Use Your Freedom Carefully

Founders have a lot of freedom in the characterization of their markets. Depending on their choices, market potential and competition – and thus also their apparent potential for growth – can vary enormously.

Investors prefer business plans in which the markets are defined smaller, but more precisely. This is usually closer to reality and proves that the founders have researched their markets thoroughly.

## Example: The Escape Room Chain

We take as an example a (fictitious) startup that wants to build a chain of escape rooms. The founders have made the following observations and decisions:

- The customer need is evening entertainment.

- The TAM consists of teenagers and adults who want evening entertainment.
- The SAM consists of young adults in large cities who want evening entertainment. This means that the competition includes other escape rooms, cinemas, bowling centers, clubs and bars.
- The SOM consists of students in southern Germany who want evening entertainment. This limitation is due to specific attributes of the startup, for example the founders' personal network or proximity to the company.

If the founders had restricted the customer need to “active evening entertainment with friends” as the customer need, then passive types of entertainment such as cinema and bars would no longer belong to the competition. The TAM is reduced in size, since not all teenagers and adults have this particular customer need. Furthermore, it might then occur to the founders to include sport centers in the list of competitors.

If the founders had chosen “unusual highlights for work outings”, the TAM would change to companies and other organizations. SAM and SOM would change accordingly. The competition would now have to include wine tasting and other such events.

In all three cases, the market potential is obtained by multiplying the number of members of the market by their average yearly spending on satisfying the customer need. In addition, the SOM calculation

has to take the envisaged market share into account. In the first SOM example this would be the number of students in southern Germany \* average amount spent by one of these students per year on evening entertainment \* proportion of that spending that the founders believe they can acquire for their escape rooms.

## This Topic's Key Question

- *Is there enough space in your market for your startup to grow fast and continuously for at least five years?*

## Link

- Topic 2.2 at [founders-playbook.de](http://founders-playbook.de):  
[founders-playbook.de/potential/market-analysis/](http://founders-playbook.de/potential/market-analysis/)