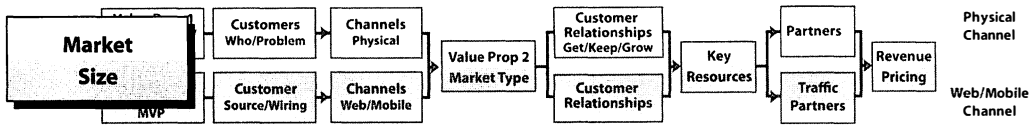
Market Size Hypothesis (Physical and Web/Mobile)



This brief is an outlier—it doesn't directly map onto the business model canvas. But because there's nothing worse than spending years in a startup only to discover that it can never grow to more than a few million dollars in revenue, the market size hypotheses help you size the opportunity of your startup market. Estimating market size helps determine whether the payoff from your new venture is worth the toil, sweat and tears, or whether you're about to do your first pivot.

Aligning investor and founder objectives clearly at the outset is good "life insurance" for founders, since few disconnects cost founders their jobs more quickly than disputes over goals and gold.

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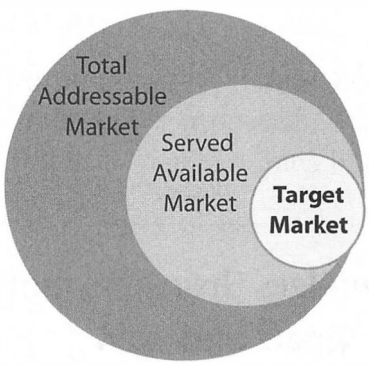
The thinking applies regardless of whether it's in the physical or web/mobile channel. With one exception: buyable startups (see page xviii) founded for a fast sale to a larger-platform player like Facebook or Google. Buyable startups should consider the size of what is often a microsegment of a large market.

Market opportunities are fueled by three ingredients: a large number of potential active users or customers, clear future-user growth in a market with rapid and predictable growth, and the opportunity to attract active customers or users.

TAM, SAM and Target Market

Marketers and their investors typically think of market size as three numbers; TAM (total addressable market), SAM (served available market) and target market. The TAM for makers of a new smartphone app might be the 1 billion total smartphone owners worldwide, but if the application is available only in English or works only on an iPhone, the SAM or potential market served is far smaller. And the target market might be Apple App Store customers, so your next step would be to estimate what percentage of those shoppers might actually buy. Each estimate further narrows the target market.



TAM = how big is the universe
SAM = how many can I reach with my sales channel
Target Market *(for a startup)* = who will be the most likely buyers

TAM, SAM and Target Market *(Figure 4.1)*

Estimating TAM and SAM and target market is a good starting point for the market size hypothesis. Customers will help turn these hypotheses into facts.

A top-down estimate is a first step. Use industry-analyst reports, market-research reports, competitors' press releases, university libraries—and discussions with investors and customers to "size" the overall market. Use whatever metric is most appropriate—units, dollars, page views, eyeballs, whatever.

A note of caution: First-time entrepreneurs are seduced by market size data from research firms. They should keep in mind that market research firms are excellent at predicting the past. (If they were geniuses at predicting the future, they'd be running hedge funds.)

Therefore, a bottom-up estimate is usually more realistic for startups. Toy makers, for example do this quite easily: there are roughly 2 million girls born in the U.S. each year, and half can't afford a $90 doll, so the U.S. target market for a new doll for girls age 6 to 8 is at most 3 million.

Market research firms are great at predicting the past.

In assessing an *existing* or *re-segmented market*, be sure to consider the adjacent markets that customers might switch from. Millions of BlackBerry users traded in their RIM devices when Apple's iPhone arrived, for example. Will the startup's new product have the competitive power to encourage switching? Count only the switchable subset and beware of long-term contracts, service contracts, and "sunk costs" like training or installation, all of which are often hidden barriers to switching.

Of course, nobody can compute a *new market's* size today, since it doesn't exist yet. What to do? Estimate the opportunity based on proxies and adjacent markets. See if there are any comparable companies. Have others grown as fast as the estimate? Why will this startup perform similarly?

⇨ Sizing the web/mobile market

While some like to quote web/mobile market sizes in terms of eyeballs, page views, downloads, referrals, or hours, at the end of the day it's still about revenue. What confuses new entrepreneurs is that web/mobile markets may be multi-sided—the users (who may not pay) may be measured in eyeballs, page views, downloads, referrals, or hours, but there had better be payers who offer dollars for access to those users.

For example, market size could be calculated by multiplying the number of eyeballs by the dollars that each eyeball is worth to a payer.

Gathering a massive, growing audience efficiently and cost-effectively is job No. 1 for most web/mobile products (e-commerce is often an exception, as are niche vertical sites). This is the time to develop an initial hypothesis about where that audience might come from and how big it can become. At this stage, most web/mobile startups follow the Google/Facebook/YouTube strategy: gather a (hopefully massive) audience first and be sure it "sticks." Monetize it later.

Gathering a massive, growing audience efficiently and cost-effectively is job No. 1.

Calculating the audience without understanding who will pay money to access that audience is a mistake. In a multi-sided market, you need to estimate all sides of the market, particularly the side that will pay.

An easy way to gauge the "size" of a web market involves the free use of Google tools. Brainstorm all the keywords that prospective customers might use to find your product or site—"multiplayer monster games," "computer games with monsters," "creatures and online games" and on and on. The Google keyword tool summarizes how many people are searching for each keyword. Make some allowances for overlap or duplication in a month and this is yet another way to develop an estimate of market size. It's especially effective at identifying whether you're in a market that's too small to pursue—one where the total number of searches is measured in thousands, for example.

Another way to approach the market-sizing question is the "30/10/10" law of web/mobile "physics," first posited by leading venture capitalist Fred Wilson. Wilson observed that, across his entire portfolio of mobile apps, games, social and music services, this law applies consistently:

- Thirty percent of registered users and those downloading mobile apps will use the service each month.
- Ten percent of registered users and those downloading mobile apps will use the service each day.
- Concurrent users of a real-time service will seldom exceed 10 percent of the number of daily users.

Industry research will also help immensely in the market-sizing exercise. Learn how to research your market in Phase 2, Customer Understanding (page 218), which describes web-specific research tools and tactics.