6. Market Analysis

The goal of a **market analysis** is to determine the attractiveness of a market and to understand its evolving opportunities and threats as they relate to the strengths and weaknesses of the firm.

David A. Aaker outlined the following dimensions of a market analysis:

- Market size (current and future)
- Market growth rate
- Market profitability
- Industry cost structure
- Distribution channels
- Market trends
- Key success factors

Market Size

The size of the market can be evaluated based on present sales and on potential sales if the use of the product were expanded. The following are some information sources for determining market size:

- government data
- trade associations
- financial data from major players
- customer surveys

Market Growth Rate

A simple means of forecasting the market growth rate is to extrapolate historical data into the future. While this method may provide a first-order estimate, it does not predict important turning points. A better method is to study growth drivers such as demographic information and sales growth in complementary products. Such drivers serve as leading indicators that are more accurate than simply extrapolating historical data.

Important inflection points in the market growth rate sometimes can be predicted by constructing a product diffusion curve. The shape of the curve can be estimated by studying the characteristics of the adoption rate of a similar product in the past.

Ultimately, the maturity and decline stages of the product life cycle will be reached. Some leading indicators of the decline phase include price pressure caused by competition, a decrease in brand loyalty, the emergence of substitute products, market saturation, and the lack of growth drivers.

Market Profitability

While different firms in a market will have different levels of profitability, the average profit potential for a market can be used as a guideline for knowing how difficult it is to make money in the market. Michael Porter devised a useful framework for evaluating the attractiveness of an industry or market. This framework, known as Porter's five forces, identifies five factors that influence the market profitability:

- Buyer power
- Supplier power
- Barriers to entry
- Threat of substitute products
- Rivalry among firms in the industry

Industry Cost Structure

The cost structure is important for identifying key factors for success. To this end, Porter's value chain model is useful for determining where value is added and for isolating the costs.

The cost structure also is helpful for formulating strategies to develop a competitive advantage. For example, in some environments the experience curve effect can be used to develop a cost advantage over competitors.

Distribution Channels

The following aspects of the distribution system are useful in a market analysis:

- Existing distribution channels - can be described by how direct they are to the customer.
- Trends and emerging channels - new channels can offer the opportunity to develop a competitive advantage.
- Channel power structure - for example, in the case of a product having little brand equity, retailers have negotiating power over manufacturers and can capture more margin.

Market Trends

Changes in the market are important because they often are the source of new opportunities and threats. The relevant trends are industry-dependent, but some examples include changes in price sensitivity, demand for variety, and level of emphasis on service and support. Regional trends also may be relevant.

Key Success Factors

The key success factors are those elements that are necessary in order for the firm to achieve its marketing objectives. A few examples of such factors include:

- Access to essential unique resources
- Ability to achieve economies of scale
- Access to distribution channels
- Technological progress

It is important to consider that key success factors may change over time, especially as the product progresses through its life cycle.