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Estimating Market Potential (Is There A Market?)

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Part 1. What The Agent Needs To Know

Your clients having decided the price they want, the geographic location of the market, their possible customers, and who and where the competition is, the next step is to calculate the portion of the market they can reasonably expect to capture. Market potential is an estimate of the amount of money your clients can expect to make from the product or service they plan to market. Their estimate will only be as good as the information they use and the assumptions they make. There are seven steps to estimating market potential, the first four of which they have already done.

1. Defining the market segment (target market),
2. Defining the geographic boundaries of the market,
3. Defining the competition,
4. Defining the market size,
5. Estimating market share,
6. Determining the average annual consumption, and

Estimating an average selling price.

Estimating the market potential will allow your clients to determine if the market will support their businesses by covering their costs and paying them a salary. Generally, the market potential is the most net revenue that they will realize from their enterprise. In the second meeting, you covered estimating your price. When they estimate market potential and use the price they calculated, they will see if they have covered their costs. One way for your clients to use their market potential analysis is to change their assumptions and see if they can still cover their costs. They can either lower their expectations of the number of people who will buy from them, or they can raise their prices. ***Writing down the assumptions they use to estimate their market potential and the changes they make to those assumptions is essential***.

The market potential is the number of potential buyers, an average selling price, and an estimate of usage for a specific period of time. The general formula for this estimation is simple

Estimating Market Potential

$$MP = N \times MS \times P \times Q$$

Where:

MP	=	market potential
N	=	total number people
MS	=	market share—percent of consumers buying from you
P	=	average selling price
Q	=	average annual consumption

To illustrate the concepts discussed, we use the agritourism example of a farmer wanting to add a corn maze and educational tour.

Define the market segment

Your clients have identified the target market of the customers who are most likely to buy from them. The target market was generally described using demographic variables: gender, age, education, and income. They are also described using psychographic variables: lifestyle, interests, and belief system variables. Your clients might have more than one target market. The most important piece of information from identifying the customers is how many fit the target market description based on the variables they chose:

- age,
- marital status,
- household income,
- gender,
- race/ethnicity, and
- education.

Since not everyone in the defined market area will be a customer, your clients need to compare their target market profile to the population in the market area. Market areas are defined in a number of ways. Some methods are easy to get data for while others are more difficult and require the services of a marketing professional.

Define the geographic boundaries of their market

Your clients have defined their market area by geography, ring analysis or radius, trade area, or drive-time. Most likely, they used geography, the simplest form of defining a market area. It defines the market area by using landmarks or some jurisdictional boundary to define the market area such as

- neighborhoods (based on U.S. Census block data),
- zip codes,
- city or county boundaries,
- Metropolitan Statistical Areas (MSA),
- state (multi-state) borders,

Define their competition

The next piece your clients need is their information about the competition. Continuing the agritourism example, your clients find who their competitors are in the market and what these people are offering. Assume your clients find three other operations with corn mazes. One has a petting zoo and pumpkin cannon included in their price. The other two operations offer the corn maze as one of several activities including pick-you-own pumpkins and apples, hay rides, a haunted house—each priced separately. Your clients decide that they will offer the corn maze and an educational tour of the farm. Each participant will get a small bag of apples at the end of the tour. The tour includes a hay ride around the farm with stops at various picture signs that point out production practices used and crops grown.

Define the market size

Once your clients have defined the market area, target market, and total number of people in that market, they calculate the number of *potential customers* for their business. The total market will typically have to be adjusted downward to account for those who will not buy from your clients. From the total people

in the target market, they estimate what percentage of consumers who would use their products or services.

Example

Assume their farm is already an agritourism operation. Your clients want to offer a corn maze as well as something educational. They decide they will target children in kindergarten through third grade. Their target market area is Wake County which has 45,700 children between five and nine years of age. Therefore, N (number of potential customers) = 45,700. They found this number in the 2000 U.S. Census.

However, not all children under nine will visit any agricultural facility. Their next step is to adjust the 45,700 to get more accurate estimate of the actual market potential. A survey of elementary school teachers showed that only 60 percent of kindergarten through third grade teachers are willing and able to take an agriculturally related field trip.

As a result, the 45,700 kindergarten through third graders needs to be multiplying by 60 percent. This calculation results in an adjusted market potential of 27,420 potential students.

$$\text{Number of Potential Consumers} = 45{,}700 * 0.60 = 27{,}420$$

Determine the average annual consumption.

Next, your clients determine how often their target market segment would use their product or service. This figure will have a significant impact on the estimated market potential. For instance, is the product purchased frequently, occasionally, or infrequently? Obviously, the more frequently the product is purchased, the larger the market potential. An abundant amount of consumption information from the government as well as industry trade associations is available. USDA collects volumes of disappearance (consumption) data for a multitude of commodities. They then convert it into per capita annual usage (consumption) estimates.

The quantity of what your clients are selling would vary based on the product being sold. For example, if your clients sell honey, the same customer may buy it five times in a season. If, however, your clients are selling hayrides, a customer may only buy one in a season. For the educational hay rides and corn maze your clients are offering, they assume that students would only come once with their classes. If your clients offer the same package on weekend or for special events like birthday parties, a student might come two or three times.

In the agritourism example, usage would be how often these school groups will take an agriculturally based field trip within the school year. The same study of elementary school teachers indicated that they will take only one agriculturally based field trip this year. Therefore, you use one as the estimate of use of agriculturally based field trips or

Q (quantity used) = 1.

Calculations for Estimating Market Share

Market share is the percentage of a market (either in number of units sold or revenue) accounted for by an individual business. This figure is important because it provides insight into how much of the total potential market your clients might capture. If the market share is not large enough to support their business, they have a problem. Also, if the number of units needed for the business to break-even financially is known, your clients can determine what share of the market they have to have for their operation to achieve this break-even point. Your clients need to be careful not to estimate an unrealistic market share. The result could spell financial problems.

Estimating market share is difficult because of the lack of information. Some trade associations or market research publications and stories will supply some basic market share information, but finding directly applicable information for your clients' business may be impossible. Your clients should estimate various scenarios based on what information they have. Remind your clients to write down the assumptions they use so that they can go back later and revise based on new information.

Assume three existing agritourism operations are in their market area. What percent of the total market might your clients be able to acquire? Since data on agritourism in the area are not collected, your clients won't be able to come up with an accurate number. However, for planning purposes, they can guesstimate a market share. In this example, it is the number of units sold, that is number of students going on the farm tour, that is being calculated.

First, your clients assume that each of the competing businesses in their market area has an equal share of the potential market or 33.3 percent of the total 45,700 children between five and nine. Next they assume that if they enter this market, they will take an equal part of each existing operation's business. Their goal is to capture 25.0 percent of the total. To calculate the market share for each of their competitors, use the formula

Market share = 100.0% ÷ number of competing businesses.
Market share = 100.0% ÷ 3
Market share = 33.3% for each of the existing agritourism businesses.

To assume your clients will get 25.0 percent of the market (assuming they divide the existing market evenly four ways) is probably unrealistic since their business is new, and the others have existing customer bases. Your clients can easily change their assumptions. For example, they assume that they can capture 3.3 percent from each of the three existing operations. They would then have 10.0 percent of the total potential market.

Using the earlier example, the total population of 45,700, your clients estimate that only 60.0% of those children would probably be able to go on a field trip. When they do the calculation, they find only about 27,420 (45,700 * 0.60 = 27,420) would actually go to an agricultural field trip. Your clients decide to use this lower number (27,420) and 10 percent for their *market share* for the first year. Your clients find they will have about 2,742 (27,420 * 0.10 = 2,742) children. This market potential number potential will give your clients an idea if their plan is feasible.

Your clients have the following pieces of information to use in calculating the market potential for their agritourism operation:

Total number of consumers (N) (Wade County census) 45,700.
Market share* (MS) (based on information from teachers times their estimate of how much of the market your clients think they can capture from their competition) 0.06.
Average selling price (P) (their cost production): $8.00.
Average annual consumption (Q) (number of visits/student based on teachers' survey): 1

MP=N x MS x P x Q
MP=45,700 X 0.06 X $8.00 X 1
MP=$21,963

(*To calculate the percent of consumers buying from your clients, multiply the percent of consumers who are potentially customers by the percent of the market they expect to capture from their competitors. In the example this calculation would be 0.6 * 0.1 = 0.06)

The market potential estimate is only as good as the assumptions your clients make and the data they use. Your clients are better off estimating on the low side and setting their price to cover their costs. If their estimate of market potential is low, they will show a profit above their costs. If, however, their estimate is too high, your clients may find it difficult to pay their bills at the end of the season.

Part 2. Worksheet for Your Clients To Complete at Home

1. Total number of people within target market area

2. Consumption (how often is the product consumed and how much of the product is consumed.)

3. Competition (number of competitors)

4. Calculating market share

How many people matching your demographics live within the defined market area?	
Market Area	Number of people (target market)
County 1	
County 2	
Total number of people	

How much product is consumed by your target customers?	
Market Area	Consumption or usage (pounds)
1. Market area 1	
2. Market area 2	
Total all market areas	

Who is your competition?		
Competitor	What offer	Price
Competitor 1		
Competitor 2		

What percent of total potential customers go to the competition?			
Competitor	Number of customers	Percent of market	Market share (customers X percent)
Competitor 1			
Competitor 2			
Total all competitors			

7. Totaling the information

Numbers you need to estimate your market potential	
Total number of potential customers (N)	
Total consumption (Q)	
Total market share (MS)	
Your price per customer (P)	

Estimating Market Potential: MP = N x MS x P x Q
Where:
MP = market potential
N = total number customers
MS = market share
P = average selling price
Q = average annual consumption (usage, number of times individual would attend)

Your numbers
MP = N x MS x P x Q

N = ______

MS = ______

P = ______

Q = ______

MP =

References

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