

MARKET SIZE ESTIMATION -- What does it all mean?

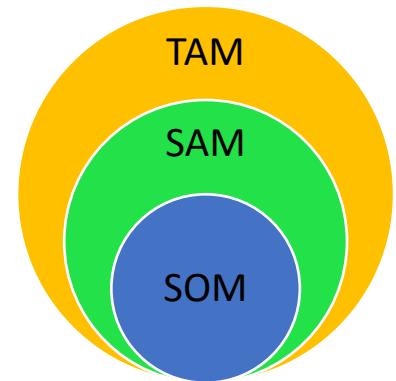
By Helen Ewing

Let's demystify how the market size helps investors determine if your startup is worth their investment. It seems like numbers are plugged into the model until it looks impressive. However, investors expect that the numbers are based on market research and a strong business plan versus wishful thinking.

THE TERMS:

TAM = Total Addressable Market:

- Expressed in dollars
- The entire market for the product sector or industry
- Excludes competition – As if you are the only source to buy from
- Represents the magnitude of interest in the **kind** of product or service your business offers. Investors⁽¹⁾ are interested in high return opportunities characterized by markets in upwards of a billion or more. (rule of thumb = ROI⁽²⁾ > 10 times their original investment).
- Every product has competition, so TAM is never reached by one company



SAM = Serviceable Available Market

- Expressed in dollars
- Is the portion of **TAM** you are growing your company to reach in as reflected in your financials
- Excludes competition – You are the only source to buy from
- Represents the magnitude of interest in the **kind** of product or service your business offers on a scale that is more realistically obtainable than TAM. While lesser amounts are acceptable in certain industries, typically hundreds of millions of dollars or more are expected in the SAM.
- Again, every product has competition, so SAM is rarely reached by one company.

SOM = Serviceable Obtainable Market Or Beachhead

- Expressed in dollars – based upon the dollars you will receive. If you will charge a different amount for the same product or service that is currently offered, the dollars are based upon what you will receive – not a simple percent of the market. Frequently, the best way to determine your dollars are to take expected unit volumes times the amount of revenue you expect for each unit.
- Is the portion of **SAM** you are starting with in order to grow/scale it over time
- Also called the 'Beachhead' market
- Includes competition – You will not be the only source to buy from
 - You would be in some towns in a few cities in one or a few states, if the US is your territory
 - You would be in a few cities in a few countries, if the world is your territory
- Represents the magnitude of interest in **your product or service**, capturing a significant percent of the SAM while using your distribution channels competing with other companies offering similar products.
- Multiple millions of dollars are anticipated by investors for the SOM to show your business may have potential. Your business plan and sales assumptions must support the SOM figure to indicate you understand the market and how to capture market share through customer sales.

1) Generally speaking, investors are of two basic types, the Venture Capitalists (VC) and Angel Investors. VC's have much higher ROI expectations in startups than Angel Investors. VC's invest several millions of dollars whereas Angel Investors invest thousands up to around one or two million. For the example here, Investor is assumed to be a VC. Angel Investors often invest at the beginning or in the seed stage of startups. They may also invest in the startup stage of a Series A round of financing. If the business is successful there, VC's start investing in the growth stages of the startup which may be part of a Series A round with later investment infusions in a Series B round and beyond depending upon the needs of the company.

2) For this explanation, ROI means selling the startup within five years.

THE EXAMPLE:

TAM

Your startup is a pub business in the United States. Your TAM is the United States pub market. If you had zero competition and were operating in every state, your business would be earning TAM dollars in sales. This shows investors what the pub market is making in sales. But, there are thousands of pubs already operating in the US. So, you will not capture 100% of TAM.

SAM



What can you realistically capture? Your first pub is going to be in a city with a significant population size of people who frequent pubs on a regular basis. Their buying behavior or demand can be measured by the sales of other pubs in the same area. The sum of those sales dollars is your SAM for that area. If you are going to start out with two pubs, in different areas, sum the sales dollars of other pubs in both of those geographic areas.

Again, SAM dollars are as if your pub were the only pub in that geographic area. SAM dollars shows investors what the pub sales potential is that you could potentially capture if your pub was so great that everyone wanted to go to your pub and no one else's.

SOM

Now it is time to tell the investors what percent of SAM you can reasonably capture by estimating SOM. For your pub, you will attract customers in prime locations where people who frequent pubs hang out, work, or socialize. There is no objective data that can prove SOM. It will have to be estimated and backed up by the strength of your business plan, sales assumptions, and distribution channels.

So, what do TAM, SAM & SOM figures mean to the investor?

The investor looks at the reasonableness of your market assumptions and research to determine how risky investing in your pub business will be. If your SOM figures are too large of a percent of SAM, the investor will doubt your plan and believe that the chance of achieving your estimates is too low for them to consider investing. If SOM is too small as a percent of SAM, the investors will not get a large enough return for their investment when the company is sold. SOM gives the investor the most information on what you think you can achieve by working your business plan.

If your pub business can achieve a significant percent of SAM over a reasonable time, then you gain credibility with investors who are seeking a ROI greater than 10 times their original investment. As the business grows, you can open more pubs in other geographic areas, repeating the same proven business plan. Opening those pubs is expensive, and you will need expansion investment money from investors to continue to grow. Eventually, your pub business will have strong enough sales where investment money (giving ownership in your pub business) will not be used, and bank loans (debt) will take investment's place as a source of capital to fuel expansion.

MARKET RESEARCH SOURCES:

Common sources: Government statistics (online), industry/trade organizations (online), Gartner reports, Risk Management Assoc. (library ref), Plunkett Research (library ref), Standard & Poor's Net Advantage (library ref), Dunn & Bradstreet (library ref), & Reference USA (library data base).

This market size explanation is a very generalized description of how it works. There are many variables that enter into market sizing for different types of products and industries. For an in-depth example with figures showing different valuations and returns with actual figures, refer to, https://www.thebusinessplanshop.com/blog/en/entry/tam_sam_som.