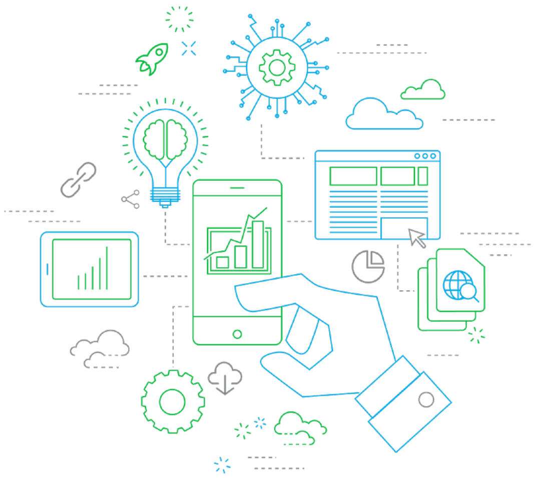
SEEKING INVESTORS?

– *Why Assessing Market Potential is Vital*

Established SaaS companies looking to scale up and enter new markets need to assess their market growth potential before attempting to raise investment capital.

Using a bottom-up approach is critical, as it determines the percentage of the market that the company's solution can realistically grow into.

Here's what companies need to consider when looking for investment backers, and what is involved in a bottom-up approach to market analysis.



3 essential 'must haves' of SaaS companies

To succeed in their markets and to gain financial backers, SaaS companies need to be much more than a solution in search of a problem. Rather, the following elements need to be in place:

1. A well-defined problem to solve, and a working and provable solution.

2. A revenue bridge.

3. Founders that demonstrate they have done their due diligence by assessing true market value potential.

All three elements are crucial.

The first demonstrates the company has pinpointed its target market and understands what its needs and pain-points are, and is able to provide a solution.

The second explains how the company makes money from its product or service.

The third point is critical when approaching investors. Without a thorough and detailed market assessment it will be difficult for investors to have faith in the company and its founders, and without that faith they won't be willing to invest!

The TAM approach to market analysis

One of the main metrics used in tech industry market analysis is Total Accessible Market or TAM.

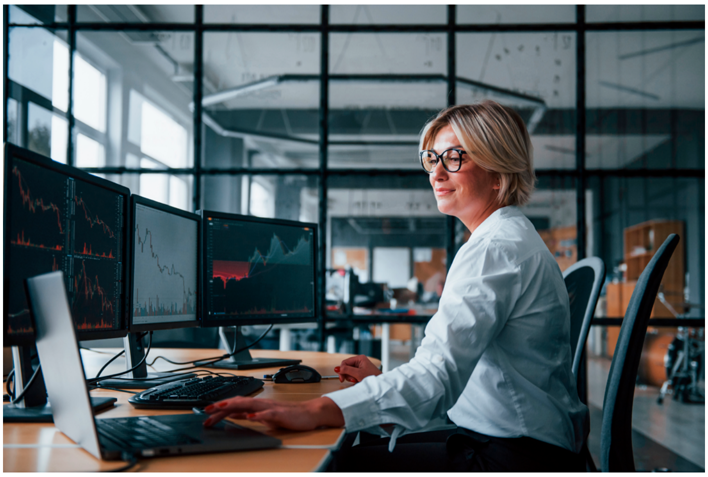
TAM refers to the total market demand for a product or service across an industry, and it is an essential metric to show when seeking private funding. However, since no business is likely to achieve 100% market share, it's necessary to drill down into the share the business can realistically achieve.

The first subset of TAM is SAM – or Serviceable Addressable Market. This is the value of TAM targeted by the product or service that is within geographical reach.

The final subset is SOM, which is the Serviceable Obtainable Market. SOM is the portion of SAM that is realistically achievable for a business.

SOM is the end-goal of TAM, as while TAM determines whether a solution has a commercially scalable market to grow into, SOM measures the market it can gain realistically.

As well as being used for estimating market share, these metrics are useful for working out the value of a tech company.



Top-down vs bottom-up approaches

A top-down approach to market assessment starts with TAM and works its way down, much like an inverted pyramid. So, you start with a wide population and drill-down to seek a market subset within that to estimate your potential market share. It may involve using various assumptions – such as assuming local market demand for products like yours will be the same as the for wider market, and so on.

A bottom-up approach works in reverse. It begins with determining demand and obtainable market share through primary and/or secondary market research, and then extrapolating that upwards to the wider population. For example, for primary market research you might directly survey potential customers about your product, while secondary research could involve checking out relevant statistical data. This information can then be expanded upwards to estimate TAM.

This approach also enables the company to explain to potential investors why it included certain market segments in its analysis while omitting others.

Another crucial difference between the two is that TAM does not measure the constraints and barriers that could prevent a company from scaling up and reaching new territory. This can only be determined through SOM. To make this happen, SOM must factor in the following:

- Product Market Fit (PMF) – whether there is a demand for the product or service compared to the competition.
- Distribution channels – there could be several barriers to reaching a large proportion of targeted customers in this regard. These may include logistics, roll-out, implementation and training requirements, sales strategy, sales team, marketing plan and capital.
- Reasonable market share percentage – growth of market percentage depends on timeframe, disruptive nature of the product, and the strength and incumbency of competition.

So in summary – bottom-up has a more accurate starting point. However, while it is often considered to be the more accurate metric of the two approaches, it will require more work and effort to calculate.

Market analysis example

Let's look at the case of a mobile phone company that has developed a new smart phone to appeal to people under 16, because it believes this market is under-serviced. The phone has built-in VPN protection to keep it safe for kids.

- **TAM** – the company plans to launch its product in Sydney. However, it will specifically target young people aged 5 to 16 – a population of 954,000 according to ABS data. So in this case, TAM is not the whole population of Sydney but the proportion of it (approximately 18%) that is aged 5-16.
- **SAM** – research indicates Apple dominates the market with a 55% share. The remaining 45% is almost all Android phones, of which Samsung has about half. So the company has a potential market share of 22.5% or 214,650 phones.
- **SOM** – barriers to achieving SAM include market competition and the sales process (such as available sales staff in Sydney). This reduces the actual market to around 24,000 phones a year or 33% of SAM.

In this example, only SOM addresses constraints and barriers within the market to arrive at a realistically achievable market.

How we can help

RSM Australia has expertise in the technology industry and is a FinTech Gold Partner. We help companies looking to scale up through our advisory and detailed financial modelling services.

But beforehand, we start with a free consultation to find out if we are a good match for your company.
Get in touch to book a call!