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4 Steps for Calculating the Potential Market Opportunity for a New Product or Service

By Chris Meering, Emil Berthelsen

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By Analyst(s): Chris Meering, Emil Berthelsen

Initiatives: Product Planning; Foundations of Product Planning

Market sizing is crucial for planning a new product or service, securing executive leadership buy-in and defining the go-to-market strategy. Product managers must employ robust and repeatable processes to quantify potential market demand and defend key business plan elements and assumptions.

Overview

Key Findings

- Many efforts to define the total market opportunity (TMO) rely on poorly segmented macrolevel market data, leading to unrealistic expectations.

- To gain executive interest/approval, product managers often create unrealistic expectations by opting for eye-catching total available market (TAM) estimates, rather than focusing on the market segment opportunity (MSO).

- TAM estimates often overlook key factors and assumptions that shape a proposal's net financial impact for the organization, resulting in a larger available market than is reflected in the total serviceable market (TSM).

- Many market-sizing initiatives fail to present the granular MSO since this may require highlighting shortcomings of the business plan and opportunity.

Recommendations

To achieve improved market-sizing activities as part of product planning, product managers should:

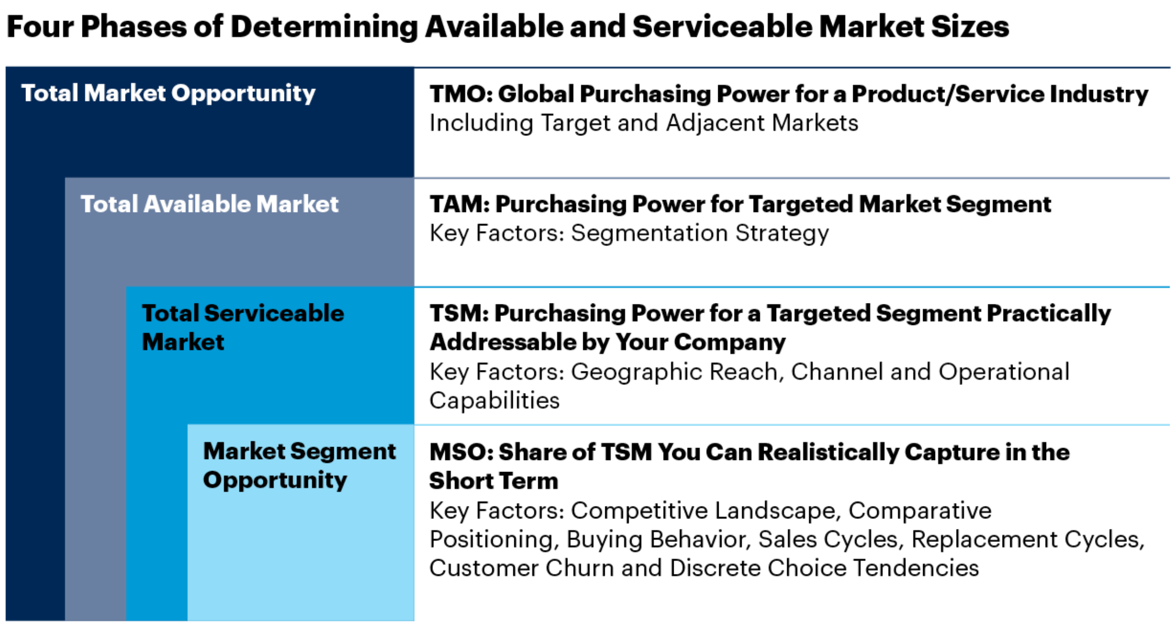
- Build defensible TMO estimates by combining top-down and bottom-up research approaches tightly focused on the target market segments for the product or service.

- Define the TAM by identifying the particular business needs of the target industry segment based on competitor activities and industry economics and driven by regulations, technology needs and buyer behavior.
- Refine the available market estimate into a TSM by estimating how many customers are expected to buy either as early adopters or as more mainstream adopters in the targeted market.
- Focus market-sizing efforts on actual financial impacts to the company by applying nuanced and detailed insights toward the business model of the product/service being analyzed.

Introduction

The assessment framework described in this research will guide product managers to crafting a well-considered estimate of opportunity and justification of that assumption starting with the TMO and segmenting this down to the MSO level. The four-step process (summarized in Figure 1) offers a framework to guide the process for calculating a feasible and defensible MSO.

Figure 1: Four Steps of Determining Available and Serviceable Market Sizes



Source: Gartner
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To generate defensible MSO estimates, product managers must master key customer and commercial dynamics. At a practical level, final revenue and market share estimates are the essential outputs of a serviceable market exercise. However, to successfully gain the buy-in of executive leadership, product managers will need to demonstrate and defend their comprehensive knowledge of their product/service and market. As highlighted in Table 1, product managers should establish a detailed understanding of the competitive dynamics, commercial terms and customer "firmographics" that underpin MSO estimates.

Table 1: Core Product Elements to Define Prior to Developing Market Size Estimates

Who Are Your Customers?	What Are Typical Commercial Terms?
▪ What kinds of companies (verticals) would procure similar products/services? ▪ What company sizes (by number of employees and total revenue) lead demand for this category of product/service? ▪ Where is the geographic distribution of target customer segments? ▪ How many potential customers are there? ▪ What does the recent economic growth look like for your potential clients? What is the expected economic climate for your clients over the next two to five years?	▪ What are typical pricing models? (Upfront payment, recurring subscription, pay-as-you-go, etc.) ▪ What are conventional financing options? ▪ What are standard practices for warranties, service-level agreements, replacement policies, etc.? ▪ What are top influences on revenue, such as in terms of channel-to-market costs? ▪ What macro and industry pressures are your potential customers facing? ▪ What problems could your product solve? ▪ How much does it cost a customer to switch providers and solutions?
What Are the Dynamics/Costs of Obtaining and Retaining Customers?	**What Are the Competitive Dynamics of the Market?**
▪ Customer acquisition and retention costs. ▪ Customer life cycle data, including typical tenure and churn rates (within category and competitive overlap from adjacent product/service categories). ▪ Top reasons/causes of customer flight. ▪ Length, complexity and cadence of sales cycle. ▪ Customer financing programs. ▪ Barriers to switching (e.g., actual cost, process complexity, opportunity cost and minimal performance gains). ▪ Are your sales and distribution channels already established?	▪ Gross revenue of competing products/services. ▪ Average EBITDA for competing products. ▪ Recent history of competitors' financial performance KPIs. ▪ Local business culture dynamics. ▪ Competitor brand equity. ▪ Competitive landscape — Is the market fragmented or consolidated? ▪ Market share of industry leaders — Heavy fragmentation can signal opportunity for consolidation or that the market is lacking in strong players. Monopolies present unique challenges.

EBITDA = earnings before interest, taxes, depreciation and amortization; KPI = key performance indicator

Source: Gartner (February 2022)

Analysis

Step 1: Build More Focused and Defensible TMO Estimates by Combining Top-Down and Bottom-Up Research Approaches

Top-down modeling is an important first step in defining market size in general terms, as well as validating the viability of the opportunity. Essentially, most top-down methodologies aggregate the sales revenue of competitors and industry analyst forecasts (such as Gartner's IT spend or Internet of Things forecasts) with data from reliable government sources and industry associations. See Note 1 for the list of additional resources to support market size estimation efforts.

This combination of data will provide product managers with an improved estimate of the total macrolevel market size for the product/service. As a first step toward defining a more realistic, feasible and obtainable market size, the TMO estimate is usually insufficient to justify a go/no-go decision for launching a new product/service. Rather, the top-down approach normally provides a rough overview of the relative size of the opportunity to determine whether further analysis is warranted.

To validate and challenge the top-down results, product managers should conduct a bottom-up modeling exercise and combine the two. In contrast to the top-down effort, bottom-up analysis relies on more specific data reflecting the customer base dynamics of the product/service. Through a combination of primary research, such as stakeholder interviews and analysis of the sales pipeline, and secondary research from third parties, the bottom-up approach will help flesh out the market landscape with a greater specificity. In particular, product managers should define the breadth of their target customer base in terms of industry verticals, company sizes and/or number of users. At that point, applying average per-customer annual revenue data to the refined customer base generates an indicative annual revenue figure for the TMO.

In some cases, the lack of reliable data means that assumptions and extrapolation are required to enable even this top level of assessment. In such circumstances, the product manager must ensure that assumptions and so forth are clearly documented and articulated so that the level of uncertainty is understood.

Building bottom-up TMO using detailed assumptions of the targeted customer segmentation means the TMO estimate will no longer be an abstract figure. Rather, it will be a more defensible estimate that takes into account the company's specific customer definitions within the context of the broader available market.

Step 2: Shift Focus From Sizing the Global Potential Market to Defining the TAM

Similarly, refining a TMO estimate into a TAM requires enterprises to honestly assess and accept the strengths and limitations of their company's operations. Establishing a meaningful TAM requires the product manager to define and calculate the number of potential customers/users within the immediate sphere of their business's influence. Applying important gating factors, such as the company's segment focus, customer attributes and operational capabilities, proves critical to narrowing the larger potential field into a more realistic potential market for their segment.

This estimate of the TAM is a subset of the TMO estimated in Step 1 (see Figure 1).

The TAM is a segment or class of prospective buyers the product manager has chosen to pursue first because of some unique positive characteristics shared by the members. This selection should be based on attributes such as (but not limited to):

- Customer needs/market challenges, such as new local regulations
- The competitive landscape (for example, targeting the weaker competitors' existing customer base)
- Common technologies needs or trends, such as the growth of cloud service adoption within that customer group
- Macroeconomic trends and megatrends in a region or customer segment

TAM is important to consider for many reasons, particularly the potential for expansion. It enables the product manager to be focused on the specific needs of one — relatively homogeneous — set of customers. This then should theoretically make it easier to move into adjacent segments (from that first segment) rather than trying to tackle everything at once.

That market could be defined by a particular need for the offering in an industry driven by government regulations, unique technology needs or buyer behavior based on industry competition and economics. It could also be the presence of special roles with unique technology needs in a particular industry (for example, the VP of manufacturing).

Target markets can also be defined and assessed by their demographic and psychographic differences. For digital business transformation, this may go beyond traditional titles, roles and technology budgets to incorporate more motivated classes of buyers and their “personas.” In digital business transformation, some classes of incumbents may be more or less prone to the threat of a class of new digital entrants. Identifying and describing that target segment in a way that shows how different they are from the rest of the potential buyers represented in the total potential opportunity at the present time inspires confidence. This confidence will boost the probability of initial success in targeted sales and marketing campaigns.

Step 3: Refine Potential Estimate Into TSMs

Establishing this third level of analysis will create a detailed fabric of the “brass tacks” of quantifying TSM for the short term. These details are meant to enhance the market analysis, while also gaining the confidence among business leaders and colleagues for them to be able to approve the business proposal. Performing this more detail-oriented third estimate will demonstrate a well-developed understanding of the market demand/supply dynamics, where critical factors will likely influence how the market adopts and incorporates the proposed product/service. This is true for both well-established product/service categories as well as new or emerging product/service types.

In this phase, the product manager should estimate how many customers within the targeted market are expected to buy either as early adopters or as more mainstream adopters. For emerging technologies, this will be accompanied by projections of factors such as:

- How long it will take for the business benefits of the emerging technology to be accepted among targeted buyers
- How long it will take for the ease of use of the emerging technology to become acceptable to all prospective buyers in the target market across each phase of adoption
- How long it will take for the price and total cost of ownership of the emerging technology to become acceptable to all prospective buyers in the target market across each phase of adoption
- At what expected intervals the expansion of the sales channel and marketing campaigns will be necessary to stay ahead of the demand in building the next expected stage of adoption

In showing these projections, product managers will also highlight to business leaders and partners their potential level of agency in moving the market to adopt the new approaches. Product managers can indicate how their involvement, investment and resources can make a difference in growing revenue over the emerging technology life cycle. It is nice to know that the TAM is potentially huge and the TSM is incredibly attractive. However, it is most important for the company's business leaders and partners to know what results they can achieve in the current phase of the market. By exposing these projections and discussing what difference their engagement will make in reaching/influencing prospective buyers in this phase, product managers will gain their trust and buy-in as strategic partners in growing revenue for both parties' mutual benefit.

For instance, if the distribution of the product or service is limited to a specific geographic area, then narrow the modeling to include the number of users or sales of that product/service only within that geographic region. A similar focus and process will be required for the product-/service-targeted vertical industries, including company revenue size category and company employee size segments, among others. It is important to recognize that the TSM is the market that could be captured with perfect execution and little to no competition. With rare exceptions, this will not be the case for the product manager's organization. Therefore, the next step in the process is to determine what market share can be feasibly obtained — effectively, the MSO.

Step 4: Expand Value of the MSO With a Focus on Actual Financial Impacts to the Company

The MSO should represent what the company can realistically expect to achieve in the target market with the existing combination of proposed product/service, operational efficiency and scale, marketing/sales channel, and distribution structure.

Therefore, refining the TSM to an MSO requires the application of more nuanced and detailed insights toward the business model of the product/service being analyzed. In particular, there are several key elements that should be applied to the TSM to gauge serviceable market share opportunity for the target segment. In addition to the detailed research already completed by this stage, companies should also consider utilizing survey and conjoint or discrete choice techniques. These techniques help to identify the best balance of brand, features, pricing and other factors that can lead to a company deciding to switch vendors. Important details these tools can identify include the following:

- How strong is the company's brand and market positioning among prospects?

- How many existing companies switch vendors or replace their equivalent product/service each year?
- What levels of product/service improvements, ROI and speed of transition are necessary to persuade customers to replace the product/service on which they currently depend?
- Do price elasticity and sensitivity trends favor the pricing structures compared with the competition?
- What are the key drivers of customer churn and switching?
- How will the offering match up against the current pricing range of similar products, and the nature of the revenue (specifically, recurring, one-time purchase, pay-as-you-go and so on)?
- What is a realistic time frame for cycles related to customer sales, onboarding and revenue recognition?

Several other factors can impact the share of the obtainable market that a business can reasonably attain. These factors include industry structure, competition level, competing approaches to gaining and improving market penetration, and the investments necessary to expand its market share.

Determining MSO is often the most difficult phase of market sizing as it forces the company to recognize and detail its strengths and weaknesses directly. Without honest and transparent internal assessment, an MSO calculation risks setting unrealistic expectations of likely business opportunity. For that reason, product managers should not be sparing in their self-criticism when building the analysis for an MSO estimate.

Evidence

The approach outlined in this document is based on the consolidated input of Gartner analysts and the strategies observed from clients during interactions.

Acronym Key and Glossary Terms

ASEAN	Association of Southeast Asian Nations
EBITDA	earnings before interest, taxes, depreciation and amortization
KPI	key performance indicator
MSO	market segment opportunity
OAS	Organization of American States
OECD	Organisation for Economic Co-operation and Development
TAM	total available market (also referred to as total addressable market)
TMO	total market opportunity
TSM	total serviceable market

Note 1: Additional Resources to Support Market Size Estimation Efforts

See Table 2 for the additional resources.

Table 2: Additional Resources to Support Market Size Estimation Efforts

Key Commercialization Dynamics	Representative Data Tools and Resources	Observations and Implications
Geographic scope (country, state and metropolitan) and target vertical industry or industries	World Bank, United Nations, OECD, EU, OAS, ASEAN, departments/ministries of industry, bureaus of labor statistics, commerce and industry/business associations, academic research, investment bank analysis reports, industry analyst reports, and federal/national/central bank studies	▪ Use data sources for comparative studies of GDP, income distribution, spending by sector, etc. ▪ Key implications for sales channels, distribution strategy, customer care infrastructure, etc. ▪ Vertical industry designations help identify unique, relevant market dynamics, as well as key filters for comprehensive data sources.
Customer demographics	Government departments of industry and economics, industry associations, public company financial reporting, and industry analyst firms	▪ Company size (e.g., by revenue and number of employees/branches), number and types of roles/positions that would use product/service, and current economic dynamics for customer segments.
Regulatory drivers and inhibitors	Regulator websites, industry associations, public company financial reports and industry analyst research	▪ Do local regulations mandate the use of specific technologies, restrict collection and use of customer data, and/or dictate commercial terms or revenue sources?
ASEAN = Association of Southeast Asian Nations; OAS = Organization of American States; OECD = Organisation for Economic Co-operation and Development		

Source: Gartner (February 2022)

Document Revision History

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Four Steps for Calculating Potential Market Share Size for a New Product or Service - 10 July 2018

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