

1.3 UNDERSTANDING MARKETS



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1.3 UNDERSTANDING MARKETS

This section of Unit 1 looks at different sorts of market. It also explains how to look at the size of a market, the future prospects of a market and the size of your business relative to others in that market.

Business ideas and the market

If you listen to the business news on TV or radio you may well hear people talking about “the market”. You can quickly work out that they are not talking about outdoor stalls and strange men selling a revolutionary new furniture polish. So what exactly do we mean by the term “market”? In simple terms, a market is where buyers and sellers come together.

Markets involve demand and supply. Demand refers to the wants and needs of consumers for a particular product. Supply refers to what businesses are doing to meet that demand. All businesses are seeking to supply a product to customers – to profit from the demand for something. Successful businesses supply products that match the needs of customers. Where there is demand by customers and businesses supply products to meet that demand, there is a market. If there is no demand for the product envisaged in a business start-up (or at any rate insufficient demand) then it can be said that there is no market for the product.

A business may provide physical goods (such as sweets or chairs), a service (such as hairdressing or legal advice) or a combination of the two. Whichever it is, we can describe what a business offers as its product. The product is offered to paying customers. Customers may or may not be the final consumer of a product. A consumer is the final user of a product. For example, small children are consumers of toys but not customers. The customers, the actual purchasers, are parents.

Classifying markets

Geographical area

A market may be local, regional, national or international. In section 1.2 we identified the scale of various national economies. These economies can be described as national markets too, but most of the time we use the term ‘market’ to look at sales of a particular product or type of product. We can talk about the UK car market, the US mobile phone market and so on. Some business start-ups are unlikely to be very concerned with knowing about the national market. They are just concerned with the local market. Somebody opening a new coffee shop in their local high street will not be focused on the national market.

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On the other hand, some small business start-ups may be operating in a national market. This particularly applies where the product is of a relatively specialised nature or the business is involved in manufacturing and has high levels of investment to recover. For instance, the market for manufacturing solar heating roof panels is (so far) quite small. A manufacturer of these panels will want to sell across the UK at least, as sales within a few miles of where the business is located would not make enough profit.

A discussion about an international market is one where the total sales by all firms across the globe are under consideration. Many businesses, even some very small ones, now look to sell across national boundaries. International markets have become more and more important in recent decades as governments have reduced the extent to which goods and services can be imported and as large businesses have sought to increase the scale of their business through gaining a share of the market in other countries.

Physical and electronic markets

The rapid emergence of the World Wide Web and other information technology means that a distinction can now be made between physical and electronic markets. Retailing is just one industry that has been particularly affected by the emergence of electronic markets. For example, bookshops and video stores have had to cope with competition from online businesses such as Amazon, Play.com and Lovefilm. These businesses operate in an electronic market. They do not have to pay rent on expensive leases in shopping centres, nor do they need as many staff, so they are able to offer very competitive prices. They are also open 24 hours a day to customers.

Web-based retailing is growing very fast and poses a serious threat to businesses that still operate in traditional physical markets. Between 2000 and 2006, online retail sales increased by 2000%. In 2008 they accounted for well over £1 out of every £10 spent by UK retail customers. Many of the companies making profits in electronic markets are small businesses who are able to meet the specific needs of a fairly small section of the market. This is known as finding a niche market (See section 1.5).

Market segmentation

A third way of classifying markets is through separating out different types of customer. This is called market segmentation. It is more fully explained in section 1.5.

ACTIVITY 5 : e-Bay

TASKS

1. Suggest why e-Bay, an example of a business trading in an electronic market, has been such a success. (5)
2. What might be the drawbacks of buying and selling through e-Bay, compared to a physical market? (5)



Is this still the best way
to buy and sell?

Measuring markets: size, growth and share

In reaching a decision about what will make a profit, a key consideration is the size of the market. But market size alone is only one part of the picture. To make a judgment about a market we will also need to know about market growth and the market share of different firms.

Market size

Market size is the amount sold by all firms supplying that product. measuring the size of the market by the financial value of sales by all suppliers is one way of measuring the size of a market. For example, the UK confectionary market is worth approximately £4 billion per year. The other way is to look at the number of units sold by all firms. This is known as the sales volume. For example, roughly 2 million new cars were sold in the UK in 2008.

Knowing how big the market is enables an entrepreneur to consider whether there is a realistic potential for worthwhile profit.

ACTIVITY 6 : Left handed guitars

What do Paul McCartney, Tony Iomi (Black Sabbath), Bob Geldof, Gruff Rhys (Super Furry Animals) and Kurt Cobain (Nirvana) have in common?

The answer is that they all play the guitar left handed. In the general population, only about 12% of people are left handed. Left handed guitarists can do one of four things:

- play a right handed guitar upside down.
- re-string the guitar before playing it upside down, so that the bass strings are at the bottom.
- play the guitar right handed (like most other people)
- buy a specially manufactured left handed guitar

Interestingly, a few right handed professional guitarists prefer to play left handed.

TASKS

1. Do you think that there would be a market for a small business to make left handed guitars? Explain your answer. (5)
2. Outline what information you might need (other than the information provided above) before making a decision. (3)

Market growth

An entrepreneur looking to start selling in a market will want to know whether consumers are spending more or less in this market over time. In a growing market there is scope for increasing sales. The timing of when a new business enters the market may be crucial though.

If there seems to be potential for market growth the trick may be to establish your product in the mind of the customer before other firms begin to enter the market, making competition tougher. The drawback with this approach is that while the market is still relatively small, there may not be much profit to be made.

Firms are rarely able to influence market growth. What they can do though is evaluate things like changes in consumer taste and social changes where such factors are likely to influence market growth. This allows firms to forecast future sales trends.

When comparing the size of the market in two different years, market growth is calculated like this:

$$\text{Year 2 sales} - \text{Year 1 sales} / \text{Year 1 sales} \times 100$$

So if a market is worth £150 million in Year 1 and £175 million in Year 2 the calculation would be:

$$175 - 150 / 150 \times 100 = 16.6 \% \text{ growth}$$

Market share

Entrepreneurs are very likely to face competition in the market. It is unlikely that a business will be the only one supplying a particular product. Each competitor will have a share of the total market.

Businesses often have the aim of becoming the market leader. This means that they have the largest market share. In some markets the advantage of being a market leader is high brand awareness among consumers.

Sometimes being a market leader can almost make the consumer feel that your firm is the only supplier of the product. (Take the example of Microsoft – how many people can name a word processing package other than Word?)

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To calculate the market share of firm A, use this formula:

$$\text{Sales of firm A} / \text{Total market value} \times 100$$

So if firm A has sales of £2 million and total sales in the market are £20 million the calculation would be:

$$2/20 \times 100 = 10\%$$

The table below illustrates percentage market share.

TOP 10 CAR MANUFACTURERS IN EUROPE	MARKET SHARE % (2007)
1. Volkswagen Group	19.7
2. Peugeot/Citroen	12.8
3. Ford Group	10.5
4. General Motors	10.2
5. Renault Group	8.7
6. Fiat Group	7.8
7. Toyota/Lexus	5.8
8. BMW/Mini	5.3
9. Mercedes/Smart	5.2
10. Honda	2.0

Source: European Automobile Manufacturers' Association



Self Check Questions

1. What is a market?
2. State two factors that influence demand
3. How is market growth calculated?
4. How is market share calculated?

ACTIVITY 7 : e-books

Is the paperback book about to die? In a few years time will we all be choosing to store most of the novels, text books, newspapers and magazines that currently clutter our shelves on a small computer? A growing number of IT companies seem to think so.

Electronic books might be just about to revolutionise the publishing world. Although global sales of e-books and e-book readers (special devices for reading e-books) are small, they are growing very fast. Most of the readers on the market use “e-ink” technology which makes the product easier to look at than a conventional PC monitor. The best ones can store hundreds of books on a device about the size and weight of one paperback. They tend to take the form of tablet computers: light, flat and without a full keyboard.

Market share and growth

The biggest market for e-readers is in the USA. Forrester Research Incorporated estimated that 2009 market sales were three million units in the USA. This was expected to increase to six million units in the following year. Major players in the US are the Kindle, from Amazon, which was estimated in 2009 to have a market share of 60% and the Sony Reader, with a 35% market share.

Apple, makers of the iPod and iPhone, launched a new tablet computer in 2010. Called the iPad, it was dubbed a veritable “Swiss Army knife of products” by technology expert Rob Enderle. The Apple tablet incorporated a Web browser as well as an e-book reader.

The key to the growth of e-books is having portable, user friendly hardware and software with which to read books comfortably. Only when digital books are as easy to use and convenient as their paper rivals will most people shift from the idea that nothing can really replace a good book. This does not seem to have happened yet. But given the speed with which the technology is developing in this market, the required shift in attitudes may not be too far away.

TASKS

1. Estimate the percentage market growth for e-book readers in the USA between 2009 and 2010. (2)
2. On the basis that the Kindle had a retail price of \$259 what was the approximate value of its market share in 2009? (3)
3. Explain how Apple's e-reader would be adding value. (3)
4. What advantages will Amazon have in the market if e-books gain mass acceptance by consumers? (4)
5. Discuss whether the e-book reader market is likely to be a highly profitable one for new market entrants such as Apple. (6)