

## Market Structure Analysis as a Value Identification Tool

### *Defining a Firm's Value*

Companies preparing for a major financial transaction (such as a line of credit, commercial bank loans, vendor financing, potential acquisition or sale, or an IPO) develop common financial reports to highlight the firms' value in advance of the transaction. However, financial reports alone are only part of total company value. The financial reports summarize information about how much revenue the firm is generating and how much money they are spending to generate the revenues. But financial reports don't provide any information about the firm's customers, its competitors, or its market potential; and these dimensions are key sources of value and ultimate market success. An accurate understanding of total value requires a comprehensive understanding of current industry performance and where the industry seems to be headed so the firm can answer the question: *is there a profitable and scalable business for the company?*

Market Structure Analysis provides key data, information and knowledge about the organization's competitive environment and the firm's current position within that environment by providing clear direction for:

- Customer Development
- Market Development, and
- Product Development.

With the support of a Market Structure Analysis a company can establish a value profile that captures a comprehensive summary of the organization's true value drivers that go beyond just the metrics in the financial reports, and provides a stronger foundation for improved terms and increased valuations, often uncovering sources of value not previously recognized by the company.

A market structure analysis can illuminate the financial reports by identifying the company's competitive position within the industry, brand strengths (and weaknesses), and highlight dimensions of value not captured by a balance sheet. Presenting an investment source with a complete catalog of value can change the parameters of the financing, improve terms, accelerate timing, and increase valuations.

[Randolphs](#) and [SME Research LLC](#) have developed a unique methodology to conduct and analyze a market structure analysis that highlights the key drivers of an industry so organizations can develop a comprehensive summary of a firm's true and total value as part of an assessment for a financial transaction. Based on an in-depth review of more than 25 years' of consulting assignments we have identified five key dimensions for developing value profiles that support funding initiatives. We have successfully used these dimensions in both nascent (emerging) and mature (growth to declining) industries. These five dimensions help us identify key performance indicators for clients and reveal key industry trends. Our secondary research and analysis provides "Industry at a Glance" summary statistics (e.g., revenue, annual growth, number of companies and market share, etc.), and an assessment of the current areas of strength and weakness for the client company. If the client company is in a strong position we will clearly identify the source of the competitive advantage, and if the client company is in a moderate or weak position we will identify a strategic path for improvement prior to the client's funding event.

### Market Structure Dimensions



#### Price/Value

Price is always relative to value, real or perceived. When someone says, “Your price is too high”, what they are really saying is “Your value is too low.” Price becomes one dimension to measure value.

Our process shows companies how to position their offerings based on the real and perceived value they provide relative to existing and/or emerging needs and competitive alternatives so that product or service price can become an optionable and executable tactical component. This section of the analysis determines the role of price in the client’s industry and may answer questions such as:

- What do customers value, particularly in comparison to competitive alternatives?
- What is the price range for current offerings in this industry?
- How price sensitive is this industry?
- Do any of the current competitors have a price advantage?
- Are prices stable; have they gone up or down over time?
- Are there opportunities for bundling, price increases, partnerships, etc.?
- What are the controlling forces for profitability in this industry?

#### Buyers

The strategic marketing literature has offered hundreds of approaches to analyze a firm’s customers, including typologies such as Usage Based Segmentations (or Benefit Based or Needs Based, etc.), PRIZM coding and other geo-demographic clustering sorts, VALS segments, affluence or value driven buyers, level of satisfaction, seasonal or regional, et al. Rather than rely on a standardized approach we customize each market structure analysis to precisely respond to the client’s current business objectives. We conduct a macro analysis of the current industry buyers and answer questions such as:

- Who is currently buying products in this industry?
- How many buyers are there?
- Where are these buyers located?
- Which product (or service) profile is most popular?
- Are current buyers satisfied with the offerings available to them?
- Are there any known problems with the usage or performance of current offerings?
- What advantages are competitor companies touting to customers?
- Are there untapped markets (i.e., customers staying out of the market at this time for some discernible reason)?
- Are consumers talking about this product / service category in the social media?

As more and more consumers have adopted and become more comfortable with Internet based social media platforms we have witnessed a swift shift in the base of power from the communication “senders” to the communication “receivers”. A recent example of consumers wielding collective power is the case of the redesigned Wonder Woman outfit. Wonder Woman is a comic book hero and NBC had plans to launch a TV show in fall of 2011 based on the character. In a stunning example of how potential “buyers” (i.e., potential viewers of this not yet on the air show) can use technology to force design changes before the product even launched, the blogosphere went into cynical overdrive when fans of Wonder Woman got a look at the outfit NBC was planning to have the lead character wear. Fans didn’t like the shiny, rubber-like pants and high heels and predicted the show would fail in a matter of weeks. The producers had no choice but to listen to the market and make changes. The shiny pants were replaced by a more natural looking fabric, the blue boots were changed to red, and those high heels are gone.<sup>1</sup> Consumer conversations in social media platforms can represent an important source of value to a firm’s product line, and they can even influence product development and marketing efforts.



### Sellers

This section of the analysis identifies the key players in the industry and profiles the major competitors. Based on a review of the other dimensions (technology, buyers, regulations and price/value) selected additional companies may also be included in the profile section if they seem poised to exploit some advantage they may have (in technology, price/value or regulatory approvals) and thereby gain substantial market share. This section of the analysis answers questions such as:

- How many companies are competing in the industry?
- Is the industry fragmented, or are there clear leaders and identifiable niche players?
- How are the key players positioned in the marketplace?
- What are the sources of value for the key players?
- Have there been recent mergers and / or acquisitions?
- Are the key players spending heavily on advertising or other marketing communications programs?
- Who owns the key Sellers?
- Who is funding the key players?
- What are the sources of competitive advantage being exploited by the major competitors?

<sup>1</sup> Mike Krumboltz, Yahoo! Buzz; Wednesday, March 30, 2011

- Are the major players selling based on some unique product or service feature, or on the lowest price, or the best distribution channels, or a technology advantage, etc.?

### *Technology*

Not many years ago industry pundits were calling technological innovations “disruptive forces”, but technology has fast become a key component of success for many industries and is now simply another piece of the corporate infrastructure. The Internet has ushered in a new trend in “consumerism” and technology platforms are available to consumers which allow them to rate, evaluate, complain, search, compare prices, and download discounts (and lots of other actions) in real time. And, companies can now narrowly target messaging and offers to increasingly discrete market sectors so that individual needs and motivations can be uniquely addressed.

The role of technology must be considered in a firm’s strategic planning initiatives. A firm’s technology choices can form the basis for competitive advantage or competitive disadvantage. An industry structure analysis answers questions such as:

- What is the role of technology in the client’s industry?
- What technology is being used by the industry leaders?
- Is the industry technology fairly stable, or characterized by frequent changes?
- How can technology choices drive competitive advantage for the firm?
- Is the technology proprietary, open, stable, affordable, game changing, etc.?
- Are technological improvements needed now?
- Does the client’s technological base support growth, or will changes be required?

### *Regulations*

Even though an industry may not be directly regulated by some governing authority they may still be constrained by industry appropriate regulations. Every company that has a presence on the Internet must be aware of and comply with privacy standards and SPAM regulations, for example. Every company that advertises on television must be aware of and comply with communication standards enforced by the FCC. Healthcare industry participants must comply with HIPPA regulations. Sometimes industry regulations are not much of an issue for a company, but sometimes they can be a source of competitive advantage or disadvantage. And they can certainly be a source of either positive or negative PR (recent examples include iPhone and Facebook and privacy challenges). This section of the market structure analysis answers questions such as:

- What are the relevant industry regulations, if any, that could affect the firm’s success?
- Are any of the industry players better positioned for compliance than others?
- Does the firm’s current product or service portfolio have any vulnerabilities or windows of strength that could be exploited?
- Are regulatory changes expected in the future?

A comprehensive market structure analysis provides a sound foundation for business planning to create value strategically, focus on growth in new directions, and manage a changing organization by providing clear direction for Customer Development, Market Development and Product Development.

<i>Market Structure Paradigm</i>		
DIMENSION	ISSUES	INSIGHTS
Buyers	<ul style="list-style-type: none"> <li>• ID customers</li> <li>• ID problem your product solves and how important problem is</li> <li>• Assess satisfaction with distribution</li> <li>• Assess satisfaction with performance</li> </ul>	<p><i>Customer Development</i></p> <ul style="list-style-type: none"> <li>• Total number of potential customers</li> <li>• Realistic share of market</li> <li>• MarCom positioning</li> </ul>
Sellers and Price / Value	<ul style="list-style-type: none"> <li>• ID competitors</li> <li>• Assess strengths and weaknesses</li> <li>• ID market shares and/or fragmentation</li> <li>• Price premium vs. low cost positions</li> <li>• Prices stable or changing</li> </ul>	<p><i>Market Development</i></p> <ul style="list-style-type: none"> <li>• Size of total market</li> <li>• New market or re – segmenting current market</li> <li>• Create new demand or steal market share</li> <li>• Competitive barriers</li> </ul>
Technology and Regulations	<ul style="list-style-type: none"> <li>• ID technologies, disruptive or sustaining</li> <li>• Exclusive advantage by any company</li> <li>• Firm’s current performance</li> <li>• Development challenges</li> <li>• Compliance issues</li> <li>• Gating regulations</li> </ul>	<p><i>Product Development</i></p> <ul style="list-style-type: none"> <li>• Stage on diffusion curve</li> <li>• Adoption rate</li> <li>• Vulnerabilities or strengths</li> <li>• User interface and experience</li> </ul>

***Market Structure Analysis “Reveals” Strategic Insights***

Our Market Structure Analysis helps a firm optimize its ability to “shape” an emerging or changing industry structure by zeroing in on the firm’s key areas of strength (the perceived value dimensions), cope with competitors, and succeed with buyers. Conventional marketing approaches were based on the premise that customer demand preceded product development. Today’s high technology environment has created a wide range of products and services that are often introduced before the user knows what the service (product) is for or how to use it. Customers have demonstrated they will give these new products a try, but they will not become regular users if real or perceived value is not evident or quickly realized. The company (seller) needs to clearly understand the sources of comparative value and effectively communicate this information to customers, users, and the financial community.

Emerging industries are being created all the time and emerging technologies are changing existing industries. Very often the rules for success are not yet established at the onset. Emerging industries are characterized by both technological uncertainty and strategic uncertainty. When the “right” strategy has not been identified some firms are tempted to proceed without focus and toss out a variety of product and market positioning programs, along with a hodgepodge of product or service configurations and technologies. Although

conceptually it is possible for a firm to succeed this way, it is more likely this approach will confuse and even alienate customers. Too often these “*throw it out and see if it sticks*” marketing approaches fail to resonate with customers.

When companies have incomplete information about competitors, about customer characteristics and usage patterns, and about industry conditions, they are not able to develop sustainable business strategies that can exploit their own areas of value and competitive advantage. As an example, Twitter has 200 million registered users and doesn't know what to do with them. Their trajectory has already flattened and they are a young company with a niche status market share.<sup>2</sup> A Market Structure Analysis could help identify what customers want (the value proposition for SMS communication), how they want to access it (technology and platforms), what they would pay for it (cellular app vs. Internet vs. something else), and who they want to get it from (cellular provider, social media platform provider, Internet provider, Google, Groupon, etc.). Customer confusion can quickly put the brakes on company growth. And when customers are confused a firm can face image and credibility problems with the financial community.

A Market Structure Analysis is a key component of the Marketing and Business Audit (MBA™) that is offered exclusively by Randolphys. The data from the key market dimensions (technology, buyers, sellers, price/value and technology) are used by our analysts to find and explain the “value” in an industry to clients and capital sources. The Market Structure Analysis provides firms with a summary of strengths and weaknesses and provides direction on priorities for improvement, growth and sustainability. When considered in total – as a system and not as functional or attribute silos – the Market Structure data and the Market and Business Audit data help reveal a brand's (i.e., a named product or service offering's) relationship with its customers and potential customers (i.e., the brand equity as dimensionalized by Kevin Lane Keller<sup>3</sup>):

- Customer awareness of the market offering (salience – do they identify with the product?)
- Customer affect for the market offering (image and performance – do they like it and are they satisfied with it?)
- Customer response to the market offering (feelings and judgments – are they happy or angry; will they spread positive word of mouth about it?), and
- Customer identification with the market offering (resonance – do they feel a “relationship” with the company and/or its offerings?).

An enhanced understanding of the customer's current relationship with the product or service category and specifically with the client company's brand provides key insight into identifying and leveraging both hidden and potential sources of value (i.e., the power of brand equity). When used as a tool in a firm's Strategic Planning initiatives a carefully executed Market Structure Analysis can:

1. Reveal the obvious and latent value in the *pricing* paradigm for an industry. The analysis on industry pricing can help a firm understand if its current offering is priced optimally or sub-optimally; if there are trends in pricing that may affect profitability; if price can be used to strategic advantage or not; if the provider will be required to sell at a lower price in order to grow share; and if the firm is at risk of being undersold by an aggressive competitor.

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<sup>2</sup> Trouble @ Twitter; CNN Money.com: April 14, 2011

<sup>3</sup> *Building Customer-Based Brand Equity: A Blueprint for Creating Strong Brands*, by Kevin Lane Keller. MSI Working paper Report No. 01-107: 2001

2. Reveal the obvious and latent value in the relationship between *buyers* and brand. The analysis on buyers can help a firm understand if buyers in the industry are characterized by brand loyalty or if they are primarily driven by price or distribution, or some other key driver. Cellular providers first introduced constricting contracts in an effort to curb the very high switching rates among buyers because there was no inherent loyalty between cell phone buyers and cellular telephony providers (the brands). ISPs faced the same problems initially with some companies reporting switching rates as high as 60%. If firms have an improved understanding of “why” customers choose their company, as well as why customers choose competitor’s offerings, they will be in a better position to maximize the perceived value of their offering and compete against the perceived value of competitors’ products.
3. Reveal the obvious and latent value in competitors’ offerings, the other *sellers* in the marketplace. The analysis on sellers can help a firm understand if competitors have a “lock” on some segments of buyers; if they have a perceived advantage in their distribution systems; if they have a competitive advantage in their cost of acquisition or materials; if they have competitive and patented technology; if they have deep pockets and can “buy” share. Often times it is also helpful to know competitors’ sources of funding, and to have a clear understanding of growth strategies (organic, acquisition, investor funding, etc.). The better the understanding of competitors’ positioning and behaviors, the better a firm’s strategy can be in defense against them.
4. Reveal the obvious and latent value in the *technology* platform(s) being used in and by the industry. The analysis on industry technology can help a firm understand if the technology in use is fairly stable or characterized by high rates of change and improvement. This section can also point out if a firm’s technology platform is a source of value or risk to the company; if customers prefer the firm’s user interface (or platform, or the cloud, or whatever dimension is most appropriate), or let a firm know if it should be considering a new approach.
5. Reveal the obvious and latent value in the industry *regulations* that apply to the firm’s line of business. The analysis on industry regulations can help a firm understand if the firm is competitive (or at risk, or perhaps the leader) in the area of regulations. If the firm has a database of user information, is it at risk of being hacked? Do customers and users feel their privacy is being adequately protected? If the firm provides cloud based services, are the sessions encrypted? If the organization is safer and more private than regulations might currently require, can the firm convert this position to additional brand value? If the analysis suggests that additional regulations may be forthcoming the firm might be in a position to take a first mover advantage from complying with them.

### *Summary*

Using a Market Structure Analysis as part of the foundation for financial valuation an organization can go beyond just the metrics in the financial reports and establish a value profile that can help improve terms and increase valuations.

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