Addressing most key strategic uncertainties starts with asking on what the answer depends. In the case of projecting sales of a major market, the need is to determine what forces will drive those sales. For example, the sales of a new consumer electronics device may be driven by machine costs, the evolution of an industry standard, or the emergence of alternative technologies. Each of these three drivers will provide the basis for key second-level uncertainties.

In the wine market, the relationship of wine to health and the future demand for premium reds might be driving forces. One second-level strategic uncertainty might then ask on what the demand for premium red will depend.

Forecasting Growth

Historical data can provide a useful perspective and help to separate hope from reality. Accurate forecasts for new packaged goods can be based on the timing of trial and repeat purchases. Durable goods forecasts can be based on projecting initial sales patterns. However, care needs to be exercised. Apparent trends in data such as those shown in Figure 4.2 can be caused by random fluctuations or by short-term economic conditions, and the urge to extrapolate should be resisted. Furthermore, the strategic interest is not on projections of history but rather on the prediction of turning points, times when the rate and perhaps direction of growth change.

Sometimes leading indicators of market sales may help in forecasting and predicting turning points. Examples of leading indicators include the following:

- ***Demographic data.*** The number of births is a leading indicator of the demand for education and the number of people reaching age 65 is a leading indicator of the demand for retirement facilities.
- ***Sales of related equipment.*** Personal computer and printer sales provide a leading indicator of the demand for supplies and service needs.

Market sales forecasts, especially of new markets, can be based on the experience of analogous industries. The trick is to identify a prior market with similar characteristics. Sales of color televisions might be expected to have a pattern similar to sales of black-and-white televisions, for example. Sales of a new type of snack might look to the history of other previously introduced snack categories or other consumer products, such as energy bars or granola bars. The most value will be obtained if several analogous product classes and the differences in the product class experiences related to their characteristics can be examined.

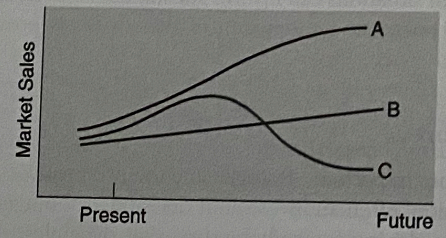

Figure 4.2 Sales Patterns

Submarket Growth

Submarket growth is usually critical because it affects investment decisions and value propositions. That involves identifying and analyzing current and emerging submarkets. While the overall beer category is flat, a deeper look shows that imports are declining, and craft beers are showing significant growth. Among restaurants, fast casual chains such as Panera Bread, Chipotle Mexican Grill, and Panda Express are fast growing.

Detecting Maturity and Decline

One particularly important set of turning points in market sales occurs when the growth phase of the product life cycle changes to a flat maturity phase and when the maturity phase changes into a decline phase. These transitions are important indicators of the health and nature of the market. Often they are accompanied by changes in key success factors. Historical sales and profit patterns of a market can help to identify the onset of maturity or decline, but the following often are more sensitive indicators:

- ***Price pressure caused by overcapacity and the lack of product differentiation.*** When growth slows or even reverses, capacity developed under a more optimistic scenario becomes excessive. Furthermore, the product evolution process often results in most competitors matching product improvements. Thus, it becomes more difficult to maintain meaningful differentiation.
- ***Buyer sophistication and knowledge.*** Buyers tend to become more familiar and knowledgeable as a product matures, and thus they become less willing to pay a premium price to obtain the security of an established name. Computer buyers over the years have gained confidence in their ability to select computers—as a result, the value of big names has receded.
- ***Substitute products or technologies.*** Sales of fresh pre-portioned ingredients with recipes delivered to customers' homes (e.g., Blue Apron) may portend a decline in frozen and packaged store bought meals.
- ***Saturation.*** When the number of potential first-time buyers declines, market sales should mature or decline.
- ***No growth sources.*** The market is fully penetrated and there are no visible sources of growth from new uses or users.
- ***Customer disinterest.*** The interest of customers in applications, new product announcements, and so on falls off.

MARKET AND SUBMARKET PROFITABILITY ANALYSIS

Economists have long studied why some industries or markets are profitable and others are not. Harvard economist and business strategy guru Michael Porter applied his theories and findings to the business strategy problem of evaluating the investment value of an industry, market, or submarket.[3] The problem is to estimate how profitable the average firm will be. It is hoped, of course, that a firm will develop a strategy that will bring above-average profits. If the average profit level is low, however, the task of succeeding financially will be much more difficult than if the average profitability were high.