Short summary # 18: Marketing Management - II Different Scales of Market Size?

TAM – Total Addressable Market
SAM – Serviceable Addressable/Available Market
SOM – Serviceable Obtainable Market

The attractiveness of a business idea is driven by many factors. One of the important ones is the market structure of the business, which provides an idea about market size, present growth, and future growth prospect, and the competitive landscape. The total addressable market or TAM is the total market size. The present growth of TAM and the competitive landscape provide a glimpse of the market structure. The TAM also helps to understand the possible future size of the business you may achieve. It helps to show your investors the big picture should they stay invested for a long time.

The Serviceable Addressable/Available Market or SAM is the market that can be captured in the medium term with adequate funding and efforts. The size of SAM indicates a rough estimate of the perception of the turnover of a new business assuming a certain reasonable rate of market penetration. The size of SAM helps investors to make a valuation of a startup and to estimate return multiples.

The Serviceable Obtainable Market or SOM is the immediate target market that a startup aims to cater to. A startup prepares itself to arrange necessary resources based on the SOM. The SOM helps to project the requirement of funds toward capital investment, sales, working capital requirements, and cash flow statements. While you present these data in the business plan, such data provide milestones to achieve and guidance about critical future strategies.

Let us understand with an example. Suppose you want to start a fashion line by setting up a chain of physical stores. Your target audience is the young population. The aggregate market in the country (or the world – if you want to market globally) of such dresses is the TAM. Now, a startup can't plan to establish the infrastructure traversing the entire country. So, you decide to set up shops in Tier-I metro cities at the beginning. The total sales of similar dresses in all such metros is the SAM. Obviously, there are other players in the market and you do not plan to set up stores all across these metros. So, you plan to cover 10% of this market both geographically and number of customer-wise, say, in two years. Based on these data, you determine the projected sales for the first two years and the subsequent years with some reasonable growth rate.

Investors want that you have a fair idea about the convincible size of TAM, SAM, and SOM. Both investors and founders take the help of these metrics to estimate the values of the startup as the company is projected to grow. Let us take a small digression to understand one frequently used method of valuation of businesses. Since startups are not expected to make a net profit in the first few years, the EBIDTA figure and a multiple thereto are frequently used to value businesses. The multiple in this case is the average of the ratios between the market values of several existing companies in a particular business domain to their EBIDTAs (determined from market data and mostly available in the public

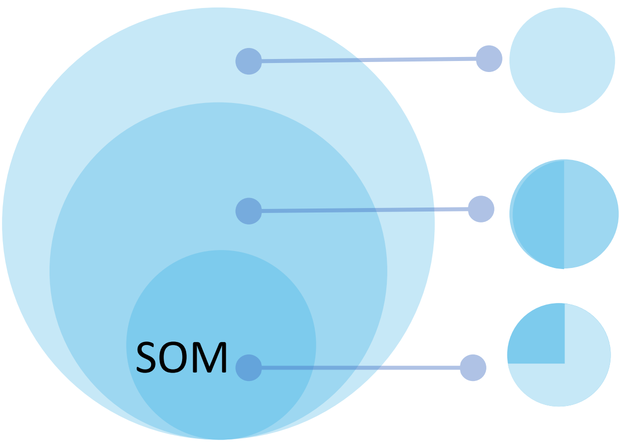
domain). The ratio varies across business domains. The ratio for businesses in computer hardware is different from that of businesses in computer software. Suppose a startup engaged in e-commerce business is projected to achieve an EBIDTA of ₹10.00 million in the 4^{th} year of operation. Suppose also that the multiple of value to EBIDTA for e-commerce companies is 30. The value of the company with EBIDTA of ₹10 million will be 10X40 = ₹400 million. If an investor is planning to invest ₹20 million today for 25% of the equity of the company, the value of their investment at the end of 4^{th} year of operation will be 25% of the total value of the company (or ₹400 million) = 0.25X400
=₹100 million. Therefore, their investment is multiplied by (100 ÷ 20) = 5 times. In startup parlance, it is shown as a 5X return. Meaning that the company can expect a 5X return in four years if they invest ₹20 million in the startup today.

Total Addressable Market

TAM is the potential sales of a product in the

TAM

entire market. The the country or the world 'entire marketdepending on the ' may mean market from where competition is expected.



Serviceable Addressable SAM Market

SAM is that portion of TAM that you may reach in the long run.

Serviceable Obtainable Market

SOM is that portion of SAM that you target to reach immediately in geographic and demographic term.

TAM: All the pastry market in India, top, medium and bottom

SAM: The pastry market that is relevant to your company – the quality & price level, the geography that is feasible to reach out to given unlimited resources and the people with specific liking of products that you make.

SOM: The market within the geographical boundary you want to cater to during the next period (may be a year or two: your projection horizon)