Home-Based Business Fact Sheet

University of Maine Cooperative Extension
Bulletin #3012

Estimating Retail Market Potential

Adapted for Maine (and co-authored) from Iowa by Jim McConnon, Extension business and economics specialist

When projecting a market's potential for your product, there is no single method for success. Competition, local income levels, product and store image, location, pricing, traffic flow, population density and other factors are used to gauge the success or failure of a new retail outlet. Even differences in product lines sold within a given store can impact the number of customers and how are they'll travel to shop.

The site can determine if your new business is a successful one. The same store or outlet may prosper in one town, but fail in another. Often, even franchised outlets within the same city meet with varying degrees of success (or failure) due to location.

The right site can determine if your new business is a successful one. The same store or outlet may prosper in one town, but fail in another.

There are many "rules" and theories to picking a site for your business. But there are just as many exceptions to these rules. The best any method can do is give you data that will help reduce the risk of starting a new business. However, none can reduce all the risk involved in a new business.

This fact sheet outlines some common retail trade area analysis methods. These methods will help you figure out the economic potential of starting a retail business in a given site, and estimate the potential of a retail store in a given community.

Intuitive method

The most common method used to select a site for a retail outlet is the intuitive method. This is the "Well, it looks good to me" method. Little planning or analysis goes into an intuitive decision. The retailer selects the site and the community simply due to its availability and the "feeling" that he or she will succeed. By simply looking at the site, he or she decides whether it's the right spot.

Another version of the intuitive method is to let the free market set the value of retail space: the more it costs to rent or buy, the more traffic it will generate. Even though it may be limited, the intuitive method may be the only method available.

The intuitive method may be the most practical if you are exploring new markets for a new and unique product line. Paid analysis is often very costly for the small operator. So the person is left with intuition, or a "gut feeling" that his or her business will succeed. It is with this entrepreneurial framework that the risks are the greatest, but the potential rewards are greatest, too.

The main purpose of any market analysis is to choose the best location to reduce business start-up risks.

Subjective method

The subjective method is somewhat more deliberate than the intuitive method. It uses more analysis than the intuitive method. However, this analysis is based upon the views of the potential retailer. Often, the subjective method relies on a checklist to find out whether a community or location is right.

Table I. SBA checklist

Use this score sheet for each site.

Grade each factor: A for excellent, B for good, C for fair and D for poor.

Factor	Grade
1. Centrally located to reach my market	______
2. Merchandise or raw materials readily available	______
3. Nearby competition situation	______
4. Transportation availability and rates	______
5. Prevailing rates of employee pay	______
6. Parking facilities	______
7. Adequacy of utilities (sewer, water, power, gas)	______
8. Traffic flow	______
9. Taxation burden	______
10. Quality of police and fire protection	______
11. Housing availability	______
12. Environmental factors (schools, cultural, community activities, enterprise of business people)	______
13. Physical suitability of building	______
14. Type and cost of lease	______
15. Provision for future expansion	______
16. Overall estimate of quality of site in 10 years	______

Source: *Starting and Managing a Small Business of Your Own*, Small Business Administration, Vol. 1, 3rd ed.

Checklists often can be scored to help you decide between sites. The rate of population growth in the community, competition estimates, traffic flow, consumer spending patterns, economic assumptions and a statement of your objectives are usually included in these checklists. Table 1 gives an example of a checklist that is included in a Small Business Administration publication.

The subjective approach to retail market analysis can give you new perspectives and flag potential pitfalls. However, the method does not include much objective analysis of market potential. It relies on the subjective views of the person doing the analysis. All too often, the person or persons thinking of starting a new business are not totally objective. They may overestimate a location's ability to attract business.

Another possible pitfall of the subjective method is that, because of the complex market, a simple checklist may not truly project actual market potential. A checklist may not include all of the factors you need to think about before selecting a community, or a site within a community. While checklists may provide a range of factors to consider, they should be used with caution.

Analogue method

The analogue method can be best described as the "If it worked there, it will here" method. Simply put, the analogue method uses the successes of the past to project the successes of the future. Large franchising corporations and retail chains often use this method in their retail analyses.

With the analogue method, you should look at the characteristics of local populations where there are successful outlets. What are the ages, incomes and occupations of nearby residents? Are there similarities in the level and type of competition? Are the successful sites located near areas of heavy traffic? Do the successful stores succeed only in towns or communities with a certain population?

If you analyze existing outlets similar to the one being planned, you may find risks involved in setting up an outlet in a similar site. Obviously, this method becomes more practical if you have experience with previous outlets. (Starting store number five is easier than starting your first store.) The less experienced you are, the more subjective this method becomes.

However, even if you are thinking about your first business, the analogue method can help. Are similar stores succeeding in communities of similar size, population mix and in similar sites? Do you have relatives or friends who have a successful business in a setting like the one you are considering? Why are they succeeding? Is the market you are looking at similar enough to markets where stores are succeeding, so you can compare them? Are there differences that affect the markets you are comparing?

The problem with the analogue theory is that no two retail markets are exactly alike. Nor are any two retail stores alike. Use caution when comparing similar markets to pick your location.

The normative method

The normative method uses secondary sources of data much like the analogue method.

However, with the normative method, you focus on what kind of market will support an average successful store. Often, this method uses census data, sales tax reports, area income data and information on the number of businesses in a given area. For example, this method may show that a town with a population of 500 won't support a furniture store, but could prove to be a good site for a gas station.

A more complex method of market analysis is to figure out the average total sales for a given market and divide this figure by the share of the market you think you will capture. With this method, you would need to know: (1) the average household disposable income for your trade area; (2) the population of your trade area; (3) the average per capita expenditure in the type of store you are considering; and (4) a reasonable estimate of your market share.

Once you have this information, you can use a formula to get estimated sales for each community. The formula is shown in Figure 1.

Figure 1. Estimated sales formula

ES = P x EXP x (ADI/MDI) x MS

ES = Estimated Sales
P = Trade Area Population
EXP = Maine Per Capita Expenditure
for Retail Outlet Category
ADI = Area Estimated Average Household Disposable Income
MDI = Maine Estimated Average Household Disposable Income
MS = Estimated Market Share

When you use the normative method to estimate the market potential of a given site, you are dealing with averages. Unless you are an average manager, in an average store, dealing with average customers, with average tastes, in the average trade area, you will be above or below the average. Since no two markets are exactly alike, it is highly unlikely that if you start a business in a given location you will have an average business. It is almost a sure bet that you will be above or below average in both sales and profits. The usefulness of the averaging method is that it provides a bench mark until you can better estimate the potential for success.

Finally, the normative method only provides an estimate of business volume; it does not displace risk.

Mathematical models

A fifth method of estimating the potential success of a new retail outlet uses mathematical models, based on secondary and survey data. Variables such as the probability of a consumer in a specific geographic area shopping at alternative sites, the driving time of consumers and the amount of square feet of retail selling area within a location might be considered.

These methods are used primarily by professional market analysts. They are often too costly for "first time" retailers and small businesses. They may involve random surveys, extensive use of computers and the use of professional experts to analyze complex formula.

Conclusion

The main purpose of any market analysis is to choose the best retail location to reduce business start-up risks. The methods listed here give you ways to gauge the success potential for locations. They range from simple to the complex. They also have varying degrees of success in forecasting a location's potential.

Perhaps the most important principle to understand in starting a business is that "There is no such thing as a sure thing." However, by analyzing and controlling risks when you choose a site, you can increase your chances of success.

References

Applebaum, William. *Shopping Center Strategy.* New York: International Council of Shopping Centers, 1970.

Berry, Brian J.L. *Geography of Market Centers and Retail Distribution.* Englewood Cliffs: Prentice-Hall, Inc., 1967.

Goldstucker, Jac L. (et al.). *New Developments in Retail Trading Area Analysis and Site Selection.* Atlanta: Georgia State University, 1978.

Neiman, Janet. *Retailers Should Know Their Place*, Advertising Age (November 1):22, 1980.

The Home-Based Business Fact Sheet Series

This is one of a series of publications designed for the person entering or considering a new business operation. See the University of Maine Cooperative Extension Online Publications Catalog for the complete Home-Based Business fact sheet series.

For more information, contact your University of Maine Cooperative Extension county office.

Published and distributed in furtherance of Acts of Congress of May 8 and June 30, 1914, by the University of Maine Cooperative Extension, the Land Grant University of the state of Maine and the U.S. Department of Agriculture cooperating. Cooperative Extension and other agencies of the U.S.D.A. provide equal opportunities in programs and employment.

Return to Publications Catalog Online Table of Contents
Return to Publications Homepage

Putting knowledge to work with the people of Maine