Stage 0: Opportunity Analysis (Part 3)

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Yes, I'm still talking about the activities completed in Stage 0. In later stages, very sophisticated methods can be used, but up here in Stage 0 there isn't much data available. Yet, this is when critical decisions impacting your success must be made.

The objective of opportunity analysis at this stage is not to forecast returns, it's to compare opportunities relative to each other, and then select the ones that have the most promise. The trick is to reverse engineer your business case. What financial factors will you eventually want to measure on your product initiatives? At the far end of the accounting, the typical factor is "Return on Sales" (ROS). This factor also goes by profit margin, net margin, and operating leverage.

ROS=Net Profit/Total Sales or in other words net profit per sale. How much are you making with each sale of your product? In opportunity analysis, we want to know what impact an opportunity will have on either 1) the number of sales we make, and/or 2) the profit we make on each sale. Estimating this impact way up in Stage 0 might seem like quite a trick. You could build a contributing factor diagram to see exactly how each factor is linked to the next.

For now, please accept that "Total Sales" are driven by two primary factors: product differentiation and market size. Product differentiation is driven by perceived value. Estimated market size is available in Stage 0 by asking, "Who would be impacted by addressing a specific problem statement?". The perceived value can be estimated by asking the market to prioritize the problem statement (of course, while you wouldn't ask the entire targeted market, there are methods you can use to get this estimate).

The typical set of factors used in Stage 0 that lead to total sales estimates are:

- Market growth rate
- Current market size
- Variability in perceived value
- Competitive density
- Opportunity leveragability
- Environmentals (political, economic, social, and technical)

I'll address each of these factors in future blog posts. Each of these factors are weighted and then added together to produce an estimate of market attractiveness. In Stage 0, Market Attractiveness drives the future metric of "Total Sales".

The "Net Profit" used in the formula above is slightly more interesting. Working our way backward, we know that "Net Profit" = revenue collected - (COGS) and/or (COS) - (MSG&A), where COGS is the Cost of Goods Sold, COS is the Cost of Services, and MSG&A is Marketing, Sales, General, and Administration expenses. Normally MSG&A is shorted to be (G&A). For product management, we normally combine COGS and COS into Cost of Offering (COO). The formula now looks like Net Profit=Revenue-[COO + G&A]. COO and G&A are further combined to just "Expenses". The resulting formula is Net Profit = Revenue - Expenses. This information isn't available at stage 0, so we look at the drivers of these factors.

For the "Revenue" term in our formula, there are two primary driving factors: perceived value and sale price. But here you run into a dead end, until you remember you don't need to know the actual value of expenses. Remember we don't need the actual value of net profit, just a comparison to other opportunities in Stage 0. Because of this, we only care about the impact this opportunity will have on the specific drivers, in this case Expenses.

The question becomes, "What impact will this opportunity have on the various factors?". Normally this is estimated by a [-3, -2, -1, 0, 1, 2, 3] scale where negative means it will reduce the current value. Sometimes, as in "Costs" this is a good thing, sometimes as in "Market

Share" it is a bad thing.

The typical set of factors used in Stage 0 leading to "Net Profit" estimates are:

- Current market share
- Growth in market share
- Brand equity
- Distribution channel access
- Production capability
- Profit margins relative to competitors

I'll address each of these factors in future blog posts as well. Each of these factors are weighted and then added together to produce an estimate of Business Unit Strength. In Stage 0, "Business Unit Strength" drives the future "Net Profit" metric.

In Stage 0, "Business Unit Strength" and "Market Attractiveness" are the two dimensions I mentioned in the other two sections of this blog series, where "Market Attractiveness" is the external dimension and "Business Unit Strength" is the internal dimension. This means in Stage 0 where data is scarce, we can still estimate and work within the margins of Return on Sales. This is done in the following chart.

Opportunities that land in the green section of this diagram will produce the greatest return on sales.

The quadrants also suggest key areas for strategic planning, but that is another post.

Tags: Tagged in: opportunity analysis opportunity identification product lifecycle management

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