Testing Before Investing

Introduction

So, you have a fantastic business or product idea… That's the hardest part done right? Not so fast. Testing the market to find out whether there is not only a demand for your product, but whether the business and product launch and development would be feasible.

Enormous amounts of money are spent every year in market testing. Before investing in a new business or product, you need to test your idea's true potential because as much as 80 percent of new products and services fail within the first year.
Your time and money are extremely valuable to you- you cannot afford to waste them by investing them in producing a product or service that fails in the marketplace. The more you test your product before you produce and sell it, the more likely you are to earn the sales and profits that you desire. Just remember, every cent you spend in market testing will save you many Rands of losses later in the marketing process.

In this paper, we will look at the various types of market testing methods that can be put into place before you decide to make the decision to invest in the product. From testing realistic size of the market that you will potentially have access to, to investigating the aspects that impact the purchasing decisions of the customer.

Market Testing

What is Market Testing?

The **Market Test** is research conducted before the commercialisation (launch) of a new product to find out the facts about the product such as; "Is the product the right one?", "Is the product reasonably priced?", "is there a demand for this product", and so on. Based on such findings, the organisation will need to make the decision to either move forward with or drop the product idea (BusinessJargons, n.d).

One thing we know about any launch is that it comes with a many different test phases. We do these phases to mitigate risk, but also to see if something will actually be successful at disrupting the industry and driving the bottom line (FuelCycle, 2019). So, how do we know what testing tests what?

Various testing phases in an agile market research strategy aim to answer different questions. The main distinction between them is what market researchers seek to find out. Not only does this warrant the need for rich data, but also the need to ask the right questions.

According to Entrepreneur's encyclopaedia definition, Market Testing is defined as a way "to test multiple marketing scenarios and select the most promising for expansion."

In layman's terms, market testing is a way to test the waters to see how well a product, service, or offering will perform with consumers … or not.
Market testing itself is made of phases of research that aim to answer questions such as (FuelCycle, 2019):

- What is the demand for my product or service?
- Who are my customers? What do customers think about my product or service vs. my competitor?
- What are the projected sales figures within a market for my product or service?
- Where and how can customers buy my product or service, so I can establish effective distribution and marketing channels?
- Is the geographical region apt for this type of product?
- What's the optimal price point?
- Will the production of my product be feasible for my business?
- Who is my competition?
- What legal obstacles stand in the way of launch?
- Which sales, advertising, display, and promotion method(s) are most effective?

The Importance of Testing the Market

The most important thing in this process is to evaluate whether an idea is a business opportunity (Delic, Peterka, & Tomasevic, 2014). Business opportunity is the initiator of business venture and it consists of a series of circumstances in the market that enable turning a business idea into a business venture. There are many tools and methods that can be used in the process of evaluation and validation of a business idea. These methods can also help in the process of modification and adaption of the business idea to the environment in which the business venture will develop. The vast majority of entrepreneurs pay too much attention to business idea and they decide to start a business venture without the necessary thinking and researching. Because of that, many business ventures fail at the beginning of their existence (Delic, et al., 2014).

Market and industry are not the same category and they should be distinguished. Market is a group of current or potential customers who are willing and able to buy a product to meet some of their needs or desires, while industry is a group of providers (sellers) who offer products and services that can be substitutes for each other (Mullins, 2003).

The importance of knowing these differences is based on different levels of attractiveness of the two areas, which can be observed at the macro and micro level. Macro-level market analysis involves collecting data on market size from secondary resources, including number of customers, availability of money for spending and annual product sales. In addition to market size, also examined is the possibility of its growth, which is based on forecasts of trends (demographic, socio-cultural, economic, technological and other frameworks) with the intention to determine whether they represent a positive aspect that will help realise the opportunity, or if entrepreneur will have a hard time countering them. The micro level refers to the market segment on which data is collected from primary and secondary resources, and is focused on finding answers in the form of existence of a market segment that is willing to pay for the added value of satisfying its needs, which is offered by a particular product, as well as the speed of its growth and the possibility of entering other market segments after conquering the first. The attractiveness of a particular market depends both on the customers, who will not buy products without differentiated benefits, and on the investors, who will not invest unless market growth is visible (Delic, et al., 2014).

As such, understanding the opportunity or even lack hereof that the market presents, is essential when making the decision to make an investment and take a new business or product to market. A realistic consideration of the size of the market, the cost involved in developing the product or service, and further establishing whether consumers would be willing to pay the price that you are considering going to market at, are all crucial components when it comes to testing the potential of the market and further making the investment.

The following looks that the various methods which should be employed to test the market in order to understand the potential as well as the risks involved prior to making that big investment.

Types of Market Testing

Market Segmentation

When considering the markets, consumer Behaviour and competitive activities, it is clear that no one product or service interests every customer. Even those customers who do buy the same product may do so for varying reasons (Baker and Hart, 2008). Market segmentation is a subgroup of people or organisation, who share one or more characteristics that cause them to have similar product needs. Goyat (2011) notes that market segmentation allows companies to focus on the customers that are within their capacity to reach, as companies cannot link to every customer in a large and varied market. A main aim of segmentation is that it allows a company to gain a competitive edge within a segment by permitting them to adjust their marketing to satisfy the specific needs of the different market segments.

Bases of Segmentation

Over time four bases have become the most popular in segmentation. The segmentation base used to divide a market depends on aspects such as what kind of product, how in demand the product is, why people buy the product, how that product is distributed (Kotler, Armstrong, Saunders, & Wong (2002) as cited in Goyat, 2011).

Geographic segmentation

Here are some examples of geographic variables that can be used:

- Region: By Continent, Country, State or by neighbourhood also
- Size of metropolitan area: Segmented per population size
- Population Density
- Climate (Goyat, 2011)

Demographic segmentation

Some examples of demographic segmentation variables include:

- Age
- Gender
- Family Size
- Family Life Cycle

- Income
- Occupation
- Education
- Generation
- Ethnicity
- Nationality
- Religion
- Social Class (Goyat, 2011)

Psychographics segmentation
Examples of psychographic segmentation variables include:
- Interests
- Activities
- Opinions
- Values

Behavioural Segmentation:
Behavioural Segmentation tends to be based on actual customer behaviour towards specific products. Some behavioural variables include:
- Benefits Sought
- Usage Rate
- Brand Loyalty
- User Status
- Readiness to buy
- Occasions (Goyat, 2011)

The idea is that companies who can effectively segment the general market and align their products and services with the needs of smaller identified segments are likely to see increased profit margins. Although it is important for companies to measure the potential gains that market segmentation might give them against the cost of the research necessary to segment the market (Goyat, 2011).

Yenkelovick (1964) as cited in Goyat (2011) stated that market segmentation needed to look beyond traditional demographic details (e.g. age, gender, education etc.) for market segmentation and focus on non-demographic traits (e.g. values, preferences and tastes) as he believed this was more predictive of customer behaviour.

Market Sizing

Market sizing refers to the practice of estimating the number of buyers of a specific product, or users of a particular service. Essentially market sizing provides insights into the viability of a business, as well as information regarding key decisions such as pricing, marketing, and the required operational and technological capacity to service the market.

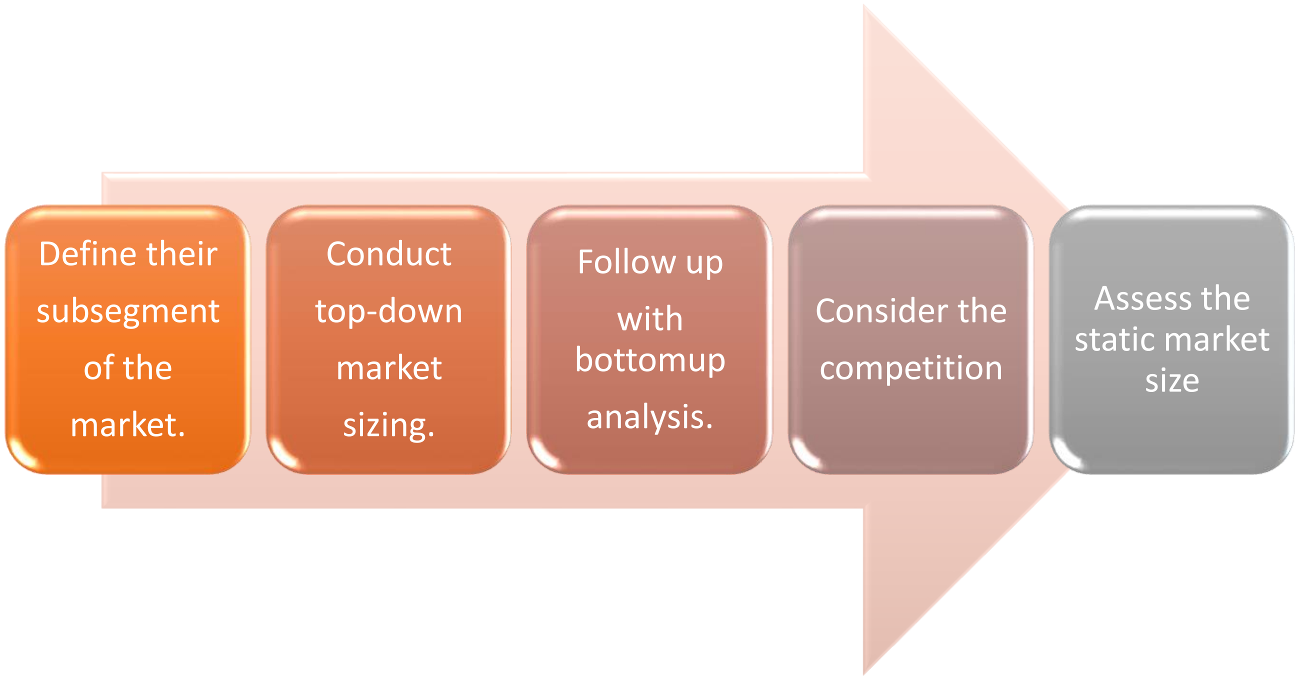
Zhuo (n.d.) notes that having insights into market size assists in differentiating between the addressable market and the available market. Addressable market refers to the total revenue opportunity for a company's product or service while available market is the portion of the addressable market that a company could realistically compete.

There are two main methods used in market sizing:

- **Top-Down Approach**: This approach encompasses defining the overall target market for a company and then applying various filters that then reduces this to an estimation of the portions of the market that the company intends to reach. Zhuo (n.d.) indicates that in this approach a company is considering the total market for their product or service, and then they establish a realistic estimate for their market share.
- **Bottom-Up Approach**: This approach sizes a market using projections of individual clusters. First the customer segments a company wishes to reach are identified and estimates regarding its size and growth are made. Zhuo (n.d.) notes that this aids in determining where a company sells their products, including how many locations would stock them and how many comparable products typically sell. This allows a company to realistically project their growth.

Market sizing allows for a company to have a sense of market trends, as well as indicating if there is a substitute for their product in the future that could potentially impact their market size (Zhuo, n.d.).

When determining a company's market size, Zhuo (n.d.) suggests the following steps:



In considering the competition, Zhuo (n.d.) suggests analysing which companies are at the forefront of the industry and how many companies are there in the same industry in order to get a realistic sense of potential market size. Working in a static market comes with competition as all the companies are competing for the same set of customers.

Feasibility Testing

A feasibility study refers to an endeavour which provides a company with enough information to decide on whether a proposed project, product or service will be useful to its intended customers and if not what preferred alternatives are best. This kind of study also assesses the strengths and challenges of the proposed product or service.

Types of Feasibility studies include:

- Operational: Define the urgency of the problem and the acceptability of any solution; If the system is developed, will it be used? Includes people oriented and social issues: internal issues, such as manpower problems, labour objections, manager resistance, organizational conflicts and policies; also, external issues, including legal aspects and government regulations, also social acceptability of the new system.
- Technical: Is the project feasibility within the limits of current technology? Does the technology exist at all? Is it available within given resource constraints (i.e., budget, schedule)?
- Economic (Cost/Benefits Analysis): Is the project possible, given resource constraints? Are the benefits that will accrue from the new system worth the costs? What are the savings that will result from the system, including tangible and intangible ones? What are the development and operational costs?
- Schedule: Constraints on the project schedule and whether they could be reasonably met

Price Testing

When launching a new product or service, it is essential for a company to decide the price they will charge. No company want so to undercharge, but at the same time they do not want to overcharge either. Finding the balance between these two can be complicated. This is where the market research tool of price testing can be used.

Pricing a product or service is one of the most important decisions a company can make (Lipovetsky, Magnan, & Polzi, 2011). Market research has developed several different approaches to pricing, these include direct methods such as estimation of willingness to pay, as well as indirect methods such as Gabor-Granger and van Westendorp techniques, and product/price mix methods such as various discrete choice models (Lipovetsky et al, 2011). Although it should be noted that when doing price testing, the company's competitors prices needs to be considered too. This will assist in understanding what expectations customers may already have regarding the product or service.

Lipovetsky et al (2011) note that there are a multitude of approaches to take with regards to pricing and they suggest that the exact method used depends on the particular circumstances of the request. They caution that direct/indirect methods are not the most accurate pricing techniques as they cannot account for competitive effects and only consider each product in isolation (Lipovetsky et al, 2011).

Ad Testing

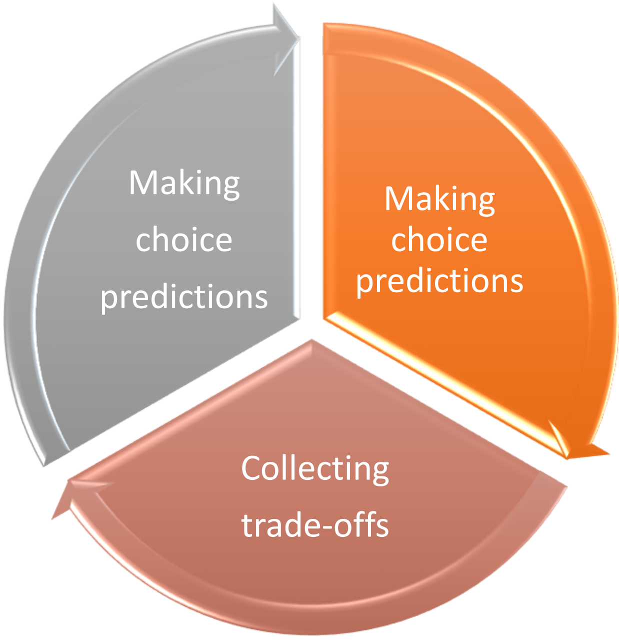
Ad testing refers to advertising research, the purpose of which is to improve the effectiveness of a company's advertising. Ad testing allows a company to determine which segments of the market to target, better understand the audience and get the highest return on investment on their advertising spending.

In ad testing, companies advertising is tested with a subset of their target market before the campaign is rolled out. To work well, ad testing needs to be clear on the purpose of the advertising. For example, is the aim to promote brand awareness or is it to drive consumer behaviour. Whatever the goal of the advertising, it is best to have this goal defined before ad testing begins. There are a variety of types of ad testing, and the type used depends on what the point in development and development the advert is at.

Conjoint Analysis

Conjoint analysis is used to investigates the aspects that impact the purchasing decisions of customers (Kuhfeld, n.d.). A product possesses different characteristics and it is not often possible for a customer to have the option of buying the product that is best in every characteristic. For example, buying a bigger car may mean more comfort and safety features but it will also be more expensive and increased fuel usage. As Kuhfeld (n.d.) notes this therefore means that customers will need to make trade-offs in their purchases and conjoint analysis is the study of these trade-offs. Essentially it measures the value customers place on the characteristics of a product or service.

Conjoint analysis is a market research technique that can assist in the design of new products, the repositioning of existing products, the identification of what features a new product should have and how it should be priced (Kuhfeld, n.d.; Curry, 1996). Conjoint analysis delivers insight into stated price sensitivity, but it does not always indicate exact price points (Chapman, 2013).
The following three steps are identified by Curry (1996) as being the basics of conjoint analysis:



The Difference Between Product Testing and Market Testing

Market testing is often confused with product testing. While it's easy to see why there are a few differences that are important to note.

- Product Testing: Research professionals are all too familiar with product testing. The unique difference here is that product testing entails observing the performance of a product by gaining feedback from consumers. This involves employing various research methodologies to attain data related to testing a product prototype with a sample of a target audience. Product testing is typically present in every new product development (FuelCycle, 2019).

- Market Testing: Market testing, on the other hand, tends to be saved for products whose performance would be difficult to predict. It could also be used when products have inconsistent or inconclusive feedback. One rather large distinction between market testing and product testing is that market testing does not involve communication with consumers, but rather the assessment of the potential of the market (FuelCycle, 2019).

The Benefits of Product Testing

When you're excited about a new product idea, it's easy to lose sight of process and preparation and rush head-long into bringing that product to market. However, taking the time to adequately test new products isn't a step that wise ecommerce sellers overlook. Testing your product before launch (Abbamonte, 2020):

Prevents wasting time and money. Testing product viability ensures that you aren't wasting your time or money in bringing a product up for sale. Bringing a product to market is no easy task—it requires a lot of investment to ensure success. By testing product viability before launch, you can gauge whether your time and money are being spent in the most effective way, or whether you need to adjust your strategy.

Opens a feedback and improvement loop. Feedback from consumers is the most valuable data you can collect to make sure you're entering the market with a product that will succeed. When you test a new product, you have a built-in phase for iterating and improving the product to better fit what your customers are looking for.

Offers insight into product demand. The testing phase can help give you a sense of how many consumers are interested in the product demand, making it easier to plan inventory when the new product it comes time to launch. This way, you can avoid spending money on more products than you can sell or providing a poor customer experience by making shoppers wait for items on backorder.

Enables strategising for future success. Maybe your product is in demand by a different audience than you expected, or for a different purpose than you had anticipated. Product testing also enables you to play around with messaging, positioning, and other elements that will determine your ability to sell successfully and help ensure the product's success later on.

Conclusion

In conclusion, without differentiated benefits, majority of customers are not going to buy, and without expected market growth, majority of investors are not going to invest in a new business venture. Understanding your product and the market you are entering is an essential first step to ensuring your business success.

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