Market Segmentation

Market segmentation involves identifying customers with common characteristics and needs. Whether individual consumers or other firms, collections of customers comprise ***markets.*** A collection of markets is said to comprise an ***industry.*** In manufacturing, examples include the automotive industry, which could be defined to consist of the new and used car markets as well as the after-market for replacement parts. Markets may be further subdivided by examining cars by makes and model years. The automotive market also could be defined regionally (e.g., North America) or by country. Each subdivision, whether by product or geographic area, defines a new market within the automotive industry.

The process for identifying a target market involves a three-step procedure. The first step entails establishing evaluation criteria used to distinguish the market to be targeted by the firm from other potential target markets. This requires the management of the firm conducting the market segmentation to determine the factors likely to affect a firm's overall attractiveness. The evaluation criteria may include market size and growth rate, profitability, cyclicality, the price sensitivity of customers, amount of regulation, degree of unionization, and entry and exit barriers.

The second step entails continuously subdividing industries and the markets within these industries and analyzing the overall attractiveness of these markets in terms of the evaluation criteria. For each market, the evaluation criteria are given a numerical weight reflecting the firm's perception of the relative importance of each criterion applied to that market to determine overall attractiveness. Higher numbers imply greater perceived significance. Note that some criteria may be given a zero weight. The evaluation criteria are then ranked from 1 to 5, with 5 indicating that the firm finds a market to be highly favorable in terms of a specific evaluation criterion.

In the third step, a weighted average score is calculated for each market and the markets are ranked according to their respective scores. The market with the highest score is considered to be the most attractive.

This three-step procedure is illustrated in the following table. Such a matrix is constructed for each market evaluated.

Industry/Market Attractiveness Matrix			
Industry or Market Evaluation Criteria[1]	Weight: (Relative Importance of Criteria)	Ranking: (5 = Highly Favorable; 1 = Highly Unfavorable)[2]	Weighted Score: (Weight × Ranking)
Market size: Is it large or small? Global, national, or regional?	.10	4	.40
Growth rate: Is it slowing, declining, or accelerating?	.20	5	1.00

Profitability: Is it currently profitable? Is it expected to remain so?	.20	4	.80
Cyclicality: Is profitability volatile?	.05	2	.10
Seasonality: Is profitability seasonal?	.00	3	.00
Customers: Are the number, average size, and needs changing?	.05	4	.20
Competitors: Is it currently highly competitive? Will competition intensify?	.10	4	.40
Suppliers: Are they reliable?	.00	3	.00
Culture: What are the emerging trends?	.00	4	.00
Regulation: Is the industry heavily regulated?	.06	4	.24
Politics: Is the political climate stable?	.05	3	.15
Labor unions: Is it heavily unionized? Are unions cooperative or militant?	.05	4	.20
Technology: What are the emerging technological trends?	.10	5	.50
Entry and exit barriers: Is it difficult to enter or leave?	.04	3	.12
Total	1.00		4.11

[1]Some of the criteria are viewed as insignificant when applied to this industry or market and are given a zero weight.
[2]The ranking is the extent to which each criterion is viewed as favorable by the firm.