
The Importance and Challenge of Market Segmentation

An Special Paper

for

BWL Marketing Class

By

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MarketAbility



Market Segmentation - Definitions

- ▶▶▶▶ Market Segmentation enables a dialogue over time with a specific group of customers, whose needs & benefits sought we understand in depth & for whom we can develop a specific offer, with a differential advantage over the offers of competitors.
- ▶▶▶▶ Market Segmentation is the technique of splitting customers, or potential customers within a market into distinct groups, or segments, within which those customers have the same, or similar requirements, satisfied by a distinct offering or marketing mix.
- ▶▶▶▶ Once described, selected & initiated, 'needs based' market segments become the foundation of both the competitiveness & forward development of a business. Each segment being defined as a 'market / product combination' – a unique & normally confidential pairing of a selected group of customers and a dedicated, tailored offering.



Credit Cards Inc.

- »»» Financial institution offering credit cards.
- »»» Market place glutted with competition.
- »»» Difficult to maintain current customer base.
- »»» New customers usually involve much greater risk.
- »»» Barrage of gimmicks and incentives has confused consumers.
- »»» The challenge: How to grow the business and make money?



Credit Cards Segmentation

- »»»» Brittain Associates reported results of an extensive survey of credit card users in 1997
- »»»» Five segments emerged based on card acquisition, card use, payment behaviour, loyalty and owners' beliefs, attitudes and opinions about credit cards:
 - »»»» Schemers
 - »»»» take advantage of all available benefits, including low rates, grace periods, billing cycles and reward benefits
 - »»»» Reward Addicts
 - »»»» base usage decisions to maximize favourite rewards (cash back, air rewards, rebates, affinity groups)
 - »»»» Bookkeepers
 - »»»» use multiple cards to categorize expenses and pay little attention to other value issues
 - »»»» Credit Addicts
 - »»»» routinely spend at levels exceeding their resources
 - »»»» Dazed and Confused
 - »»»» unaware of rates, fees, rewards, billing cycles, grace periods, competitive choices



Credit Cards Segmentation

- »»»» Bruce Brittain, President, Brittain Associates explains:
- »»»» These segments do not follow demographics, so two people from the same age group can fall into different segments
- »»»» All five segments have their unique profile, for instance
 - »»»» Schemers
 - »»»» love teaser rates but have no loyalty
 - »»»» Dazed and Confused
 - »»»» usually loyal, even if the card is super-expensive

- »»»» Can you think of other segments?



MBNA

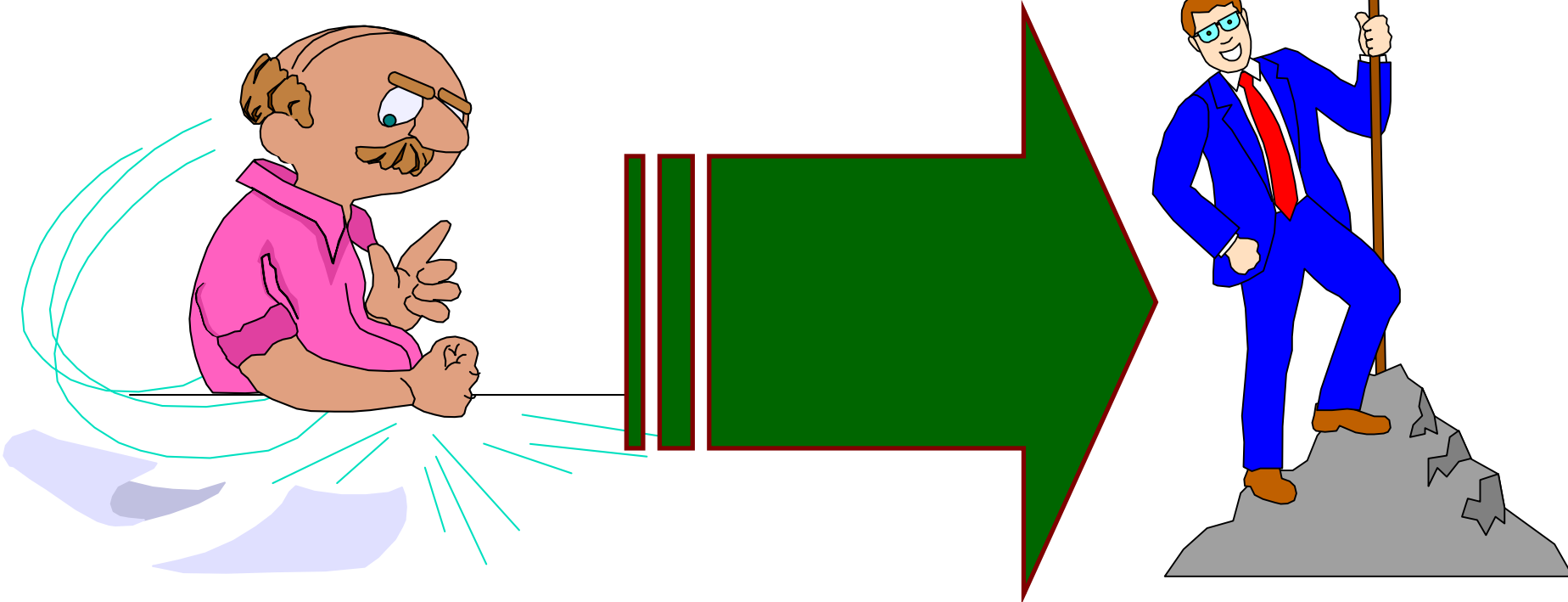
- ▶▶▶▶ Hypothesized a **unique** segmentation model.
- ▶▶▶▶ Consumers who were affiliated with an institution, or loyal to a particular group (ie University Alumni)
- ▶▶▶▶ **Profile:** Well educated, good job, willing to support their school, likely users of credit, good credit risk.
- ▶▶▶▶ Created a Customer Value Proposition to **Organizations:** A means to increase your contributions from members & alumni while providing them with something of value.
- ▶▶▶▶ The Customer Value Proposition to **Users:** A chance to give something back to your organization while enjoying all the benefits of a credit card.
- ▶▶▶▶ **MBNA Affinity** cards - by giving the organization a cut of the service fees, MBNA get access to a very low risk group of consumers, keeps their advertising costs to a minimum, and has created huge growth
- ▶▶▶▶ 1997 net income rose 30%



What is Market Segmentation?

✓ SEGMENTATION IS:

✓ DIFFICULT AND CHALLENGING



✓ REWARDING IF YOU ARE SUCCESSFUL

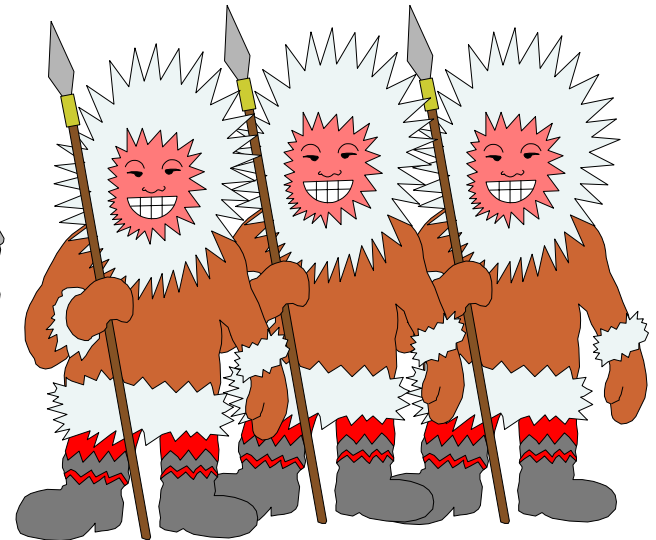
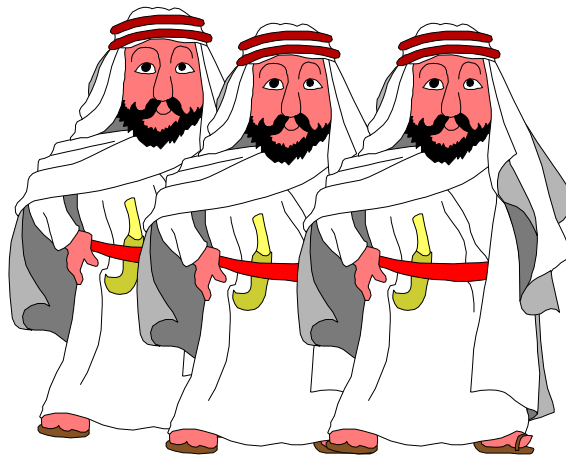
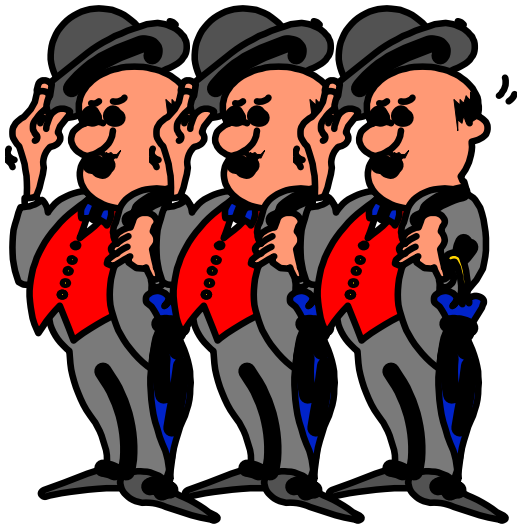


Segmentation: How to segment

»»» Understand customer needs, decision criteria and buying behaviour



»»» Group customers who have similar needs or behaviour



What is Market Segmentation?

✓ SEGMENTATION IS:

- »»» Grouping customers according to drivers of supplier preference
- »»» Grouping customers based on similar need or behaviour
- »»» Grouping customers according to determinant factors in supplier choice
- »»» Applied to ALL customers in the market
- »»» Companies within a segment have similar needs or behaviour
- »»» The needs of different segments are different



What is Market Segmentation?

✓ SEGMENTATION IS:

- »»» The basis to choose where we will compete
- »»» The basis for identifying opportunities
- »»» The basis for developing competitive advantage
- »»» The basis for creating a superior Value Proposition
- »»» **Anticipate unmet, unidentified or future needs of customers**



Segmentation: Why segment?

»»»» **To make your life easier**

- »»» Understand the market more clearly by grouping customers who will react in a similar way to a marketing offering
- »»» Understand drivers of choice and preference in the market
- »»» Discover a basis for competitive advantage
- »»» Identify opportunities to create customer value
- »»» Establish a basis for Value Proposition development

»»»» **To help others to understand**

- »»» Target customers more effectively and serve their needs better
- »»» Communicate customer needs to others in Your Company
- »»» Help colleagues to understand what you expect from them

»»»» **To create a platform for continuous improvement**

- »»» Establish a framework for critical review of the market
- »»» Monitor the market, anticipate change and stay ahead



Segmentation: Why segment?

»»»» **Differentiation**

- »»» Target groups of customers who will respond in a similar way to a Value Proposition and marketing mix
- »»» Define a sound basis for superior value delivery
- »»» Find profit opportunities for differentiated offerings

»»»» **Value Growth**

- »»» Establish a basis for market analysis and understanding
- »»» Understand the growth drivers in each segment

»»»» **Productivity**

- »»» Target customers more effectively and serve their needs better
- »»» Identify where to exploit or develop competitive advantage
- »»» Focus resources on target segments and de-emphasize non-target segments

»»»» **Re-examine your business model**

- »»» Change the way you do business

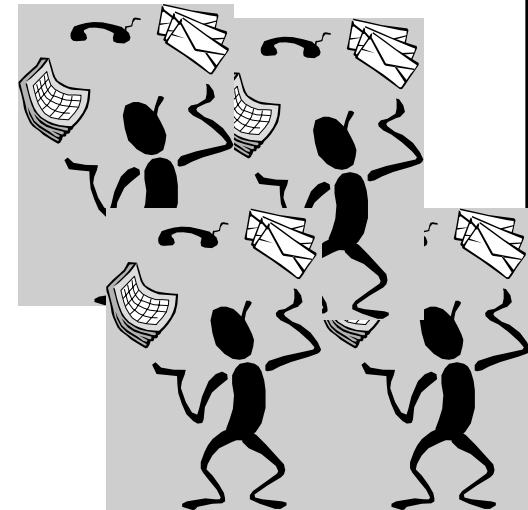


Segmentation: Target Where to Compete

Define the market thoughtfully

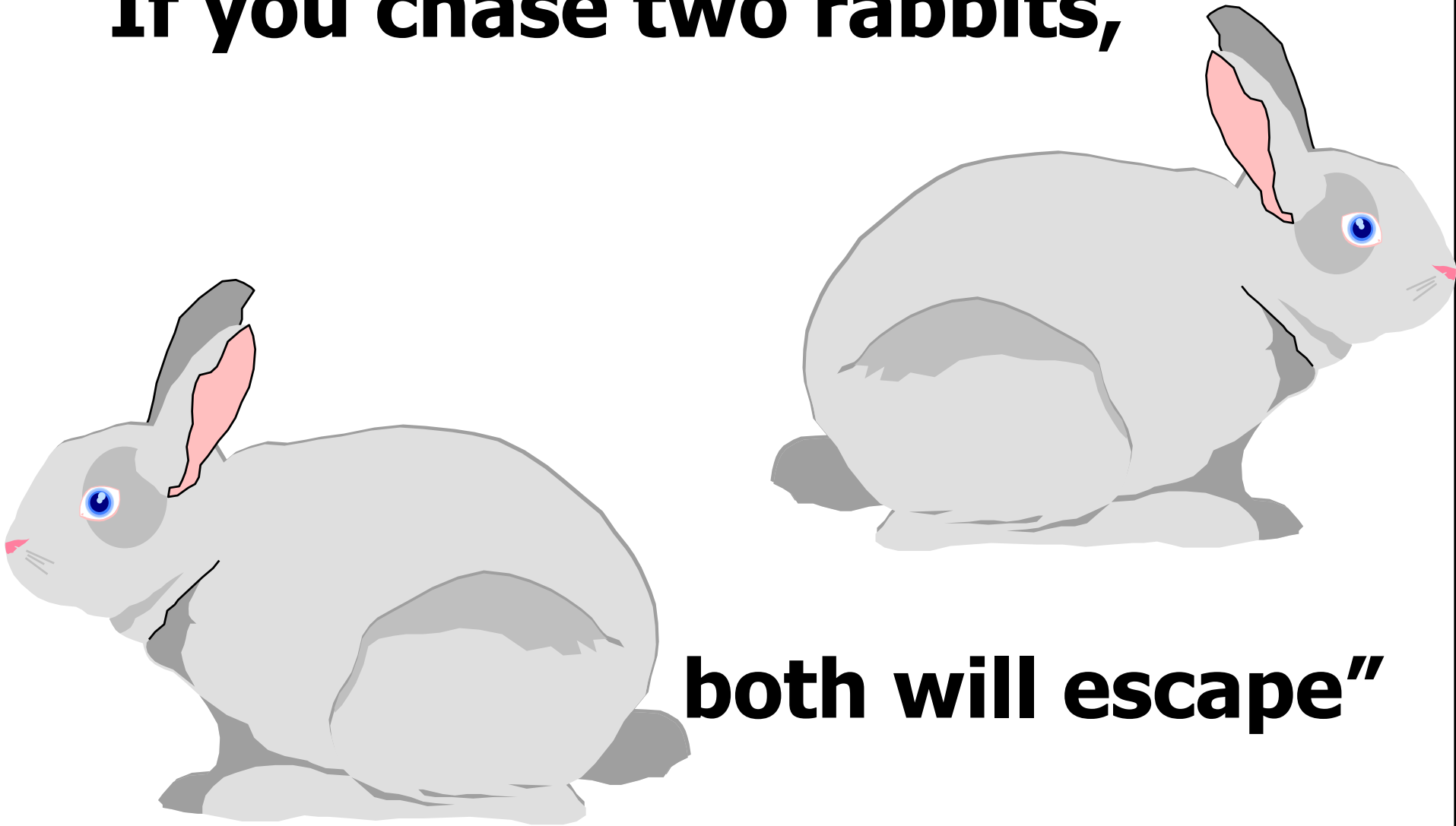


Evade costly head to head competition by defining segments innovatively – avoid 'industry standard' terms & conventions used for grouping customers



Choose Target Segments

“If you chase two rabbits,

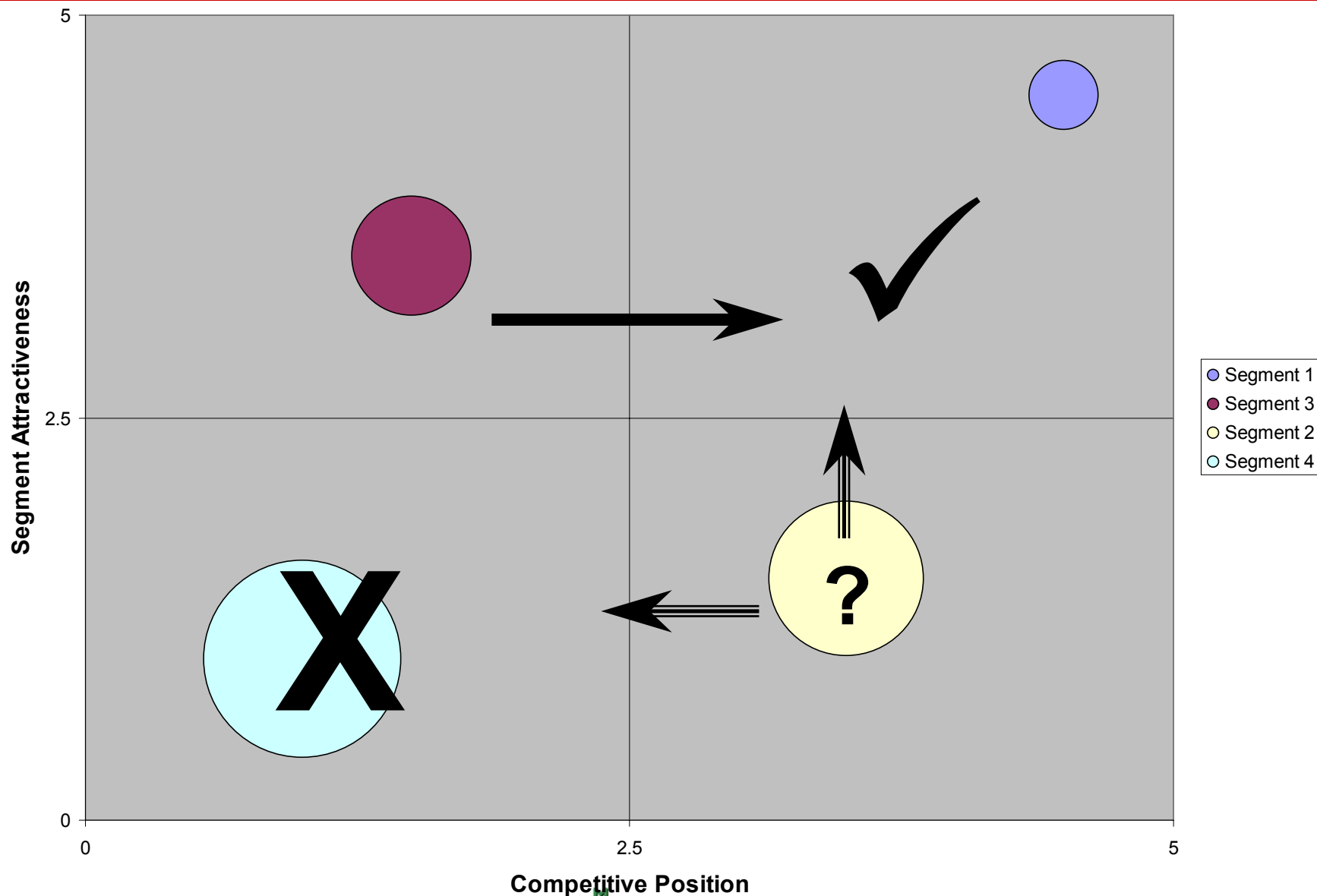


both will escape”

Anonymous



Directional Policy Matrix (DPM)



The Challenge of Segmentation

- »»»» There is no formula for segmentation
- »»»» Segmentation demands a blend of analysis and creativity
- »»»» Segmentation must examine the whole market
- »»»» Segmentation must reflect the reality of the market
- »»»» Segmentation must explain WHY people make the buying decision - on what basis
- »»»» Segmentation must be meaningful for YOU
- »»»» Segmentation must enable you to make choices about where to compete
- »»»» Segmentation must tell you what offering will succeed with customers in a segment



Competing for Market Success

- ▶▶▶▶ Identify customer segments based on benefits they value or needs they have
- ▶▶▶▶ Target segments where your strengths and competencies can deliver greatest success
- ▶▶▶▶ Be BEST at delivering benefits to target customer segments (where you can impact customer success)
- ▶▶▶▶ Organise to deliver greatest benefits to target customers
- ▶▶▶▶ Do all this better than your competitors
- ▶▶▶▶ **Do NOT try to satisfy ALL needs of ALL customers**



Packaging Inc.

- »»» Company's segmentation approach:
 - »»» Size - small, medium, large, national accounts
 - »»» SIC code - primary metals, forest products, cotton, brick etc
- »»» Within each segment
 - »»» Low-price seekers - "commodity" product
 - »»» Service seekers - "value-added" product
- »»» This view of the market did not seem to be bringing them the desired success
- »»» What to do?
- »»» How to do it better?



Signode Corporation

- »»»» Analysis of customer buying behaviour
 - »»» 174 national accounts (40% of Signode's revenue)
 - »»» 12 buying behaviour variables → Cluster Analysis
- »»»» Identified 4 segments, based on buyer behaviours
 - »»» **Programmed** - little knowledge of competitive offerings, product not important to operations, neither price nor service sensitive, unlikely to switch
 - »»» **Relationship** - more knowledge of competitive offerings, product quite important to operations, paid lower price/got more services, might switch
 - »»» **Transaction** - very knowledgeable of competitive offerings, product very important to operations, preferred price over service, not hesitant to switch
 - »»» **Bargain** - most knowledge of competitive offerings, product very important to operations, sensitive to any changes in price or service, very likely to switch

Source: Prof. V. Kasturi Rangan, Harvard Business School



What did Signode Corporation do?

- »»» **Directed sales reps** handling *programmed buyers* accounts to focus their efforts on changing buying decision-making strategies in order to increase share at these accounts
- »»» Offered **additional service** to *bargain hunters* to try to improve sales volume beyond the estimated break-even point. National Account Managers took active role
- »»» For *relationship buyers* and *transaction buyers*, a **separate service management group** was created to explore ways to add service value for these customers

Source: Prof. V. Kasturi Rangan, Harvard Business School



Key Steps in Market Segmentation

1. Define and Map the Market

- describe the needs, solutions, value chain, all producers through all channels to all consumers

2. Identify the Customer

- identify key players in the value chain
- how are suppliers selected and on what basis?
- what is the decision-making process?
- who are the key decision-makers and influencers?

3. Identify Key Buying Decision Criteria

- what are the key determining needs for each decision-maker in order of priority in the buying/ supplier selection decisions?
- identify unmet or poorly met needs

4. Discover Segments

- at each relevant level in the value chain, group customers with similar needs or behaviour

5. Validate the Segments

- do the segments make sense, fit your knowledge of the market?

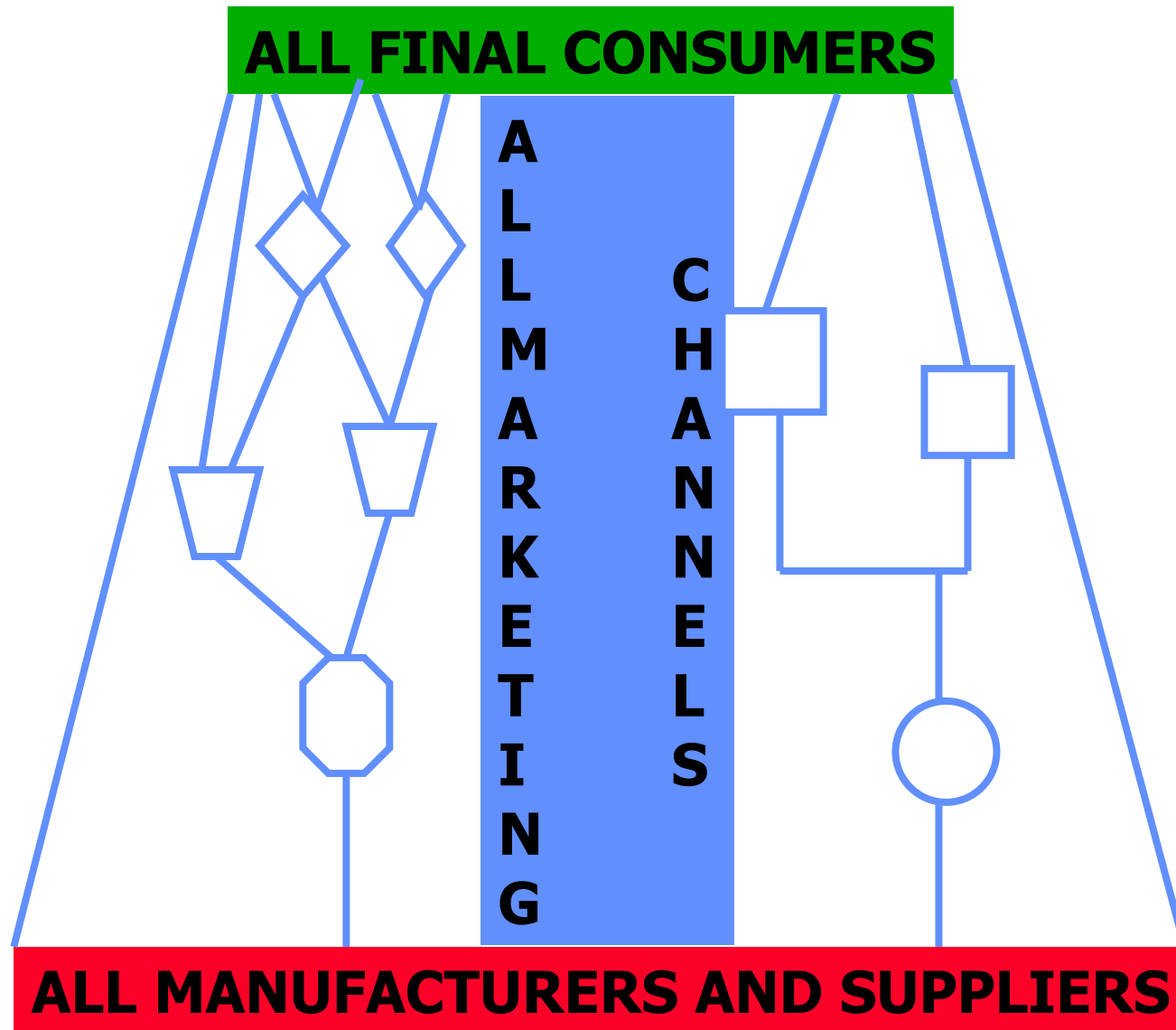


1.1 Define and Map the Market

- »»» Describe the needs, solutions, value chain
 - »»» ideally you should start at the customer end and build from there
 - »»» if that is not intuitive, start with a product-market
 - »»» map the market (the levels of detail will vary from business to business)
 - »»» describe the value chain, name it (based on needs/benefits)
 - »»» identify the end-user (last member of the value chain to derive or recognize a benefit or value in your offering)
 - »»» at this level, look for relevant bases on which to group customers, based on what drives their buying decisions and behaviour
 - »»» repeat this for all levels above the end-user
 - »»» we recommend to find a basis which explains **why** people make the buying decisions they make, this is usually best found through an analysis of **need and behaviour**



Market Maps Cover the Whole Market



The Simple Market Value Chain

***Manufacturer/
Service Provider***



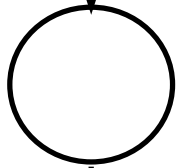
**Direct
Customer**

**The direct purchaser of your product,
service or offering**



End User

**The last member in the Value Chain
who recognises a value or derives a
benefit from your product, service or
offering**



Consumer

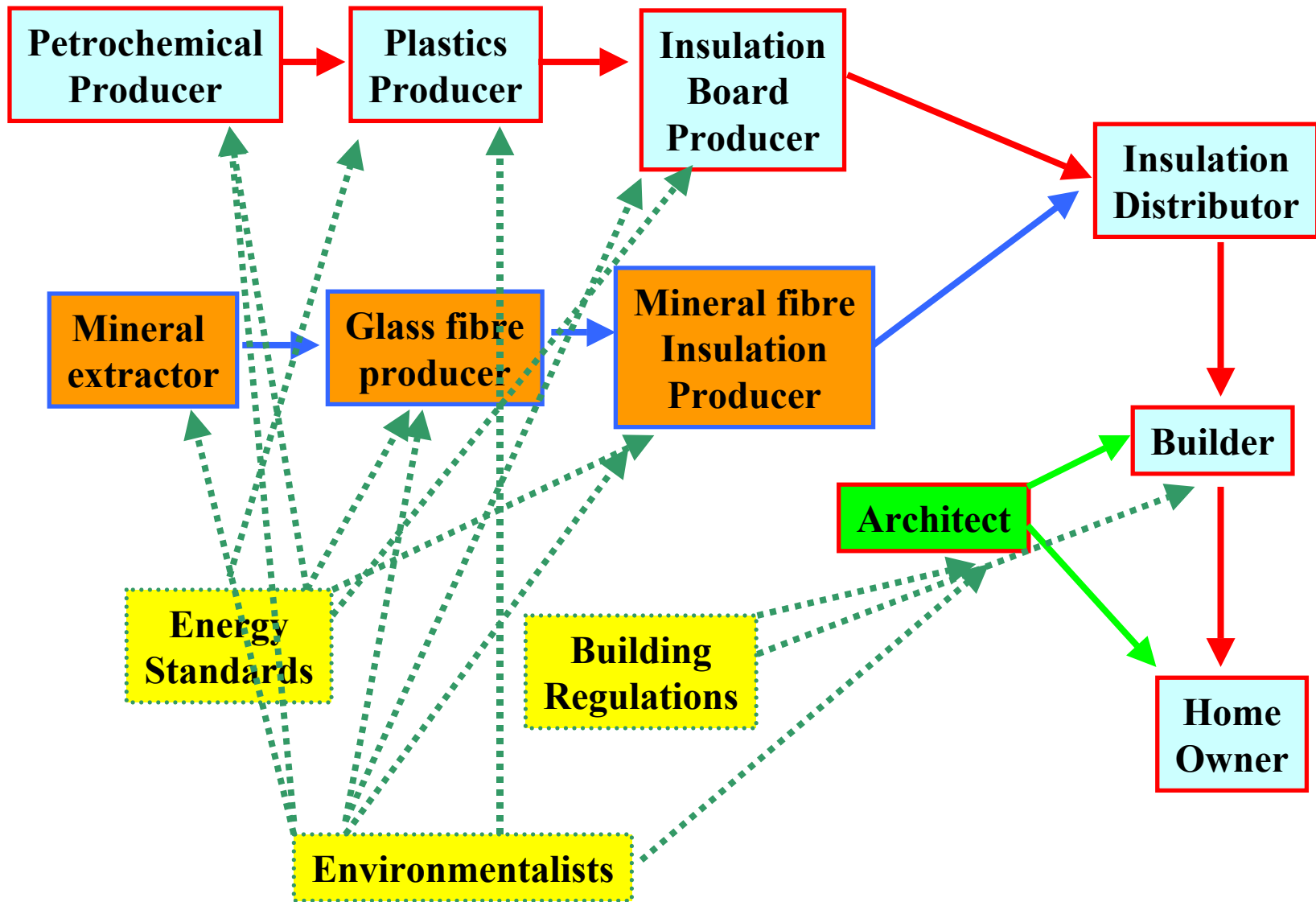
**The ultimate user of a product or the good
containing your product as a component.**

**IDENTIFY
DOMINANT
VALUE
CHAIN
MEMBER**

**The
most
knowledgeable
influential or
controlling
member
of a
Value
Chain**



Market Map: Warm home owners

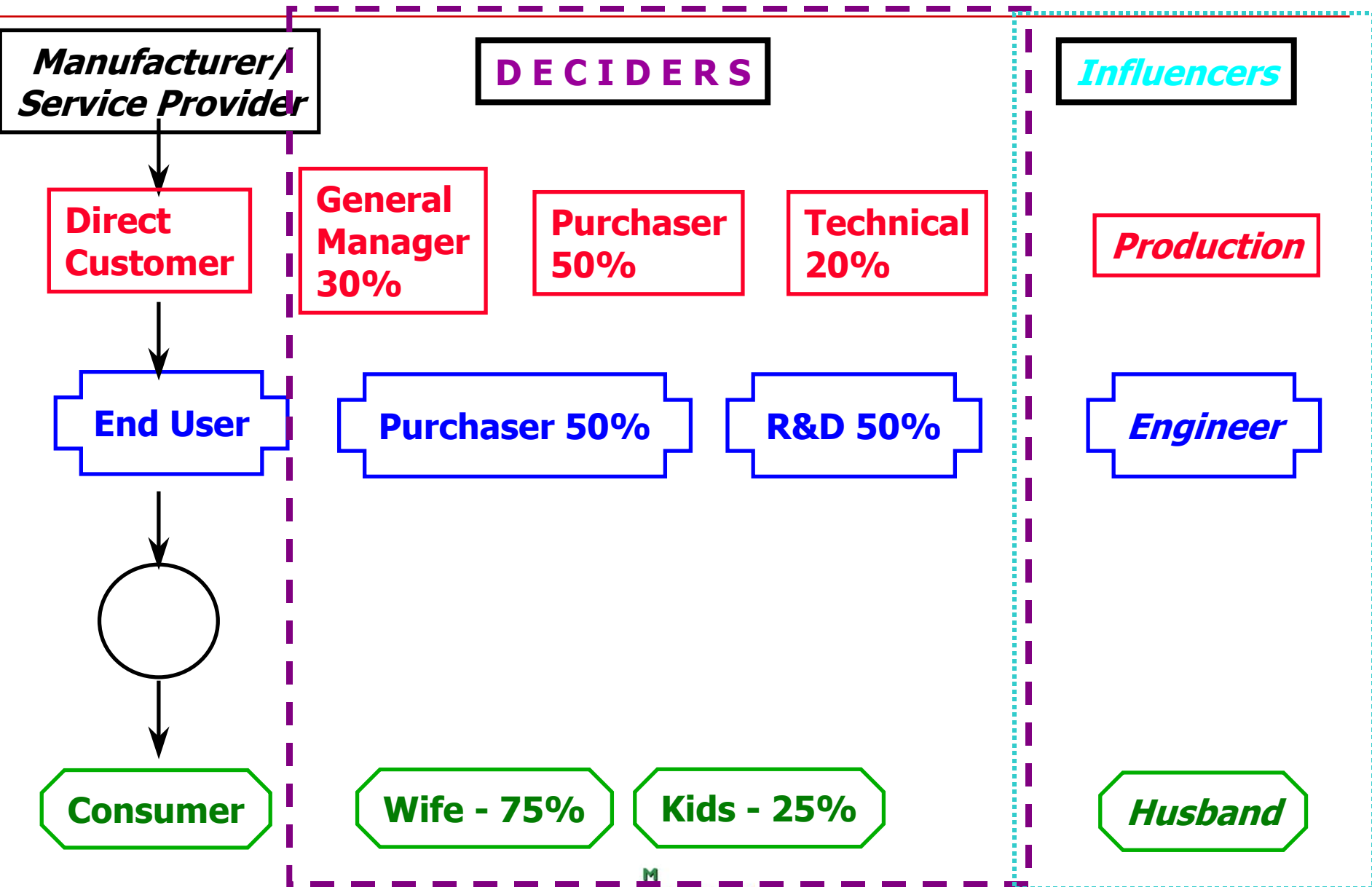


Complex Buying Units

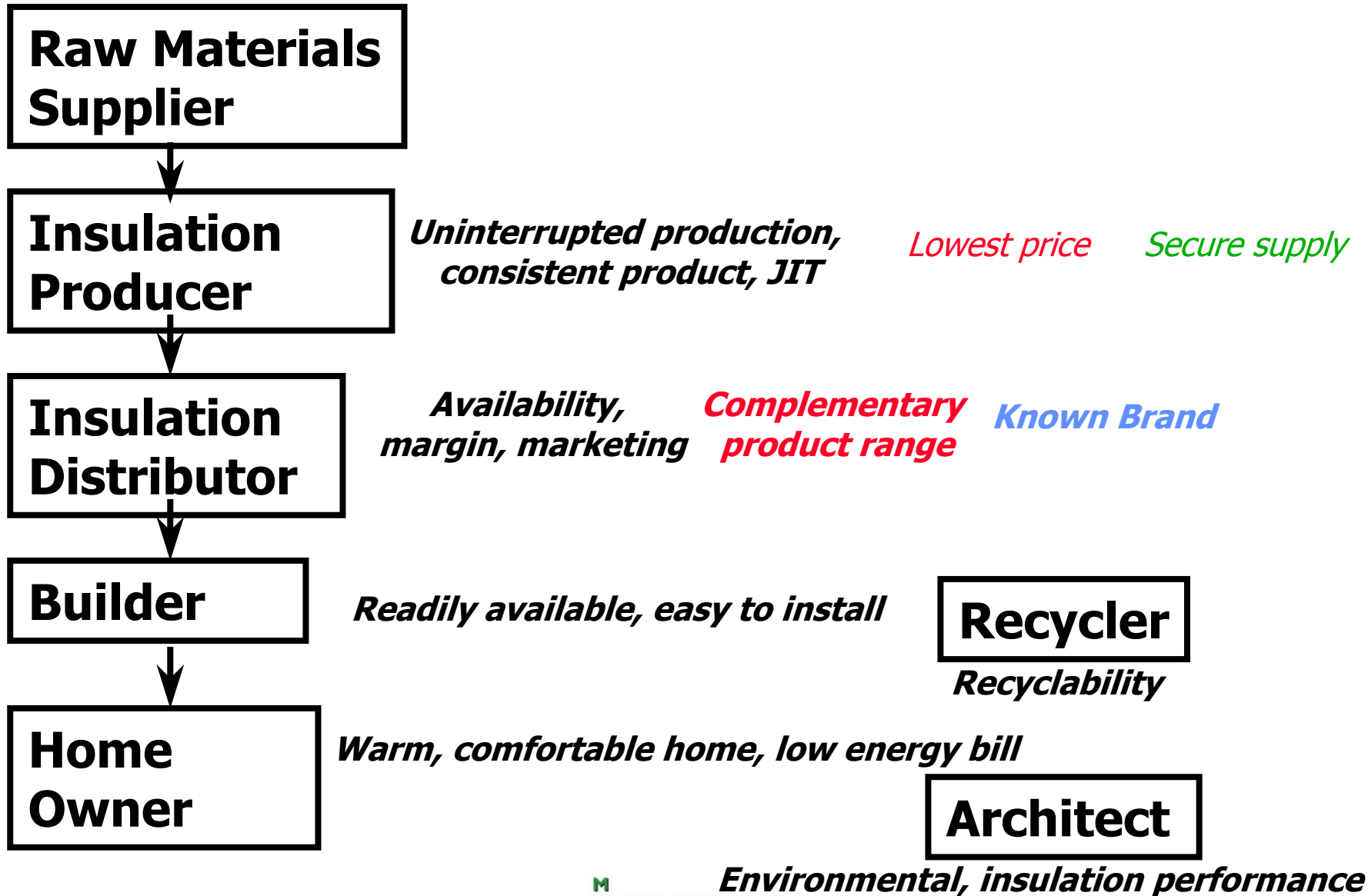
- »»» In many industrial product-markets, the buying decision involve a multitude of players
 - »»» Purchasing
 - »»» Technical
 - »»» Production
 - »»» Engineering
 - »»» R&D
 - »»» General Management

- »»» The Value Chain needs to account for the complex buying decision-making unit

The Expanded Market Value Chain



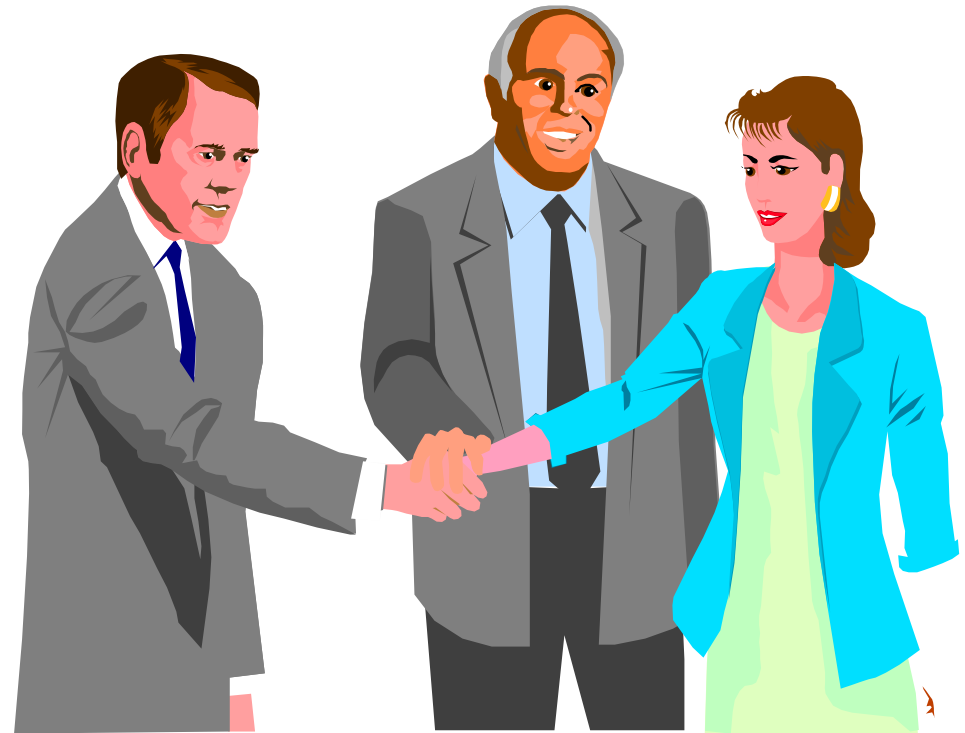
Value Chain: Needs



Environmental, insulation performance

Who is the customer?

- ▶▶▶ Any member of the value chain who can directly or indirectly purchase or influence the purchase of your products and services



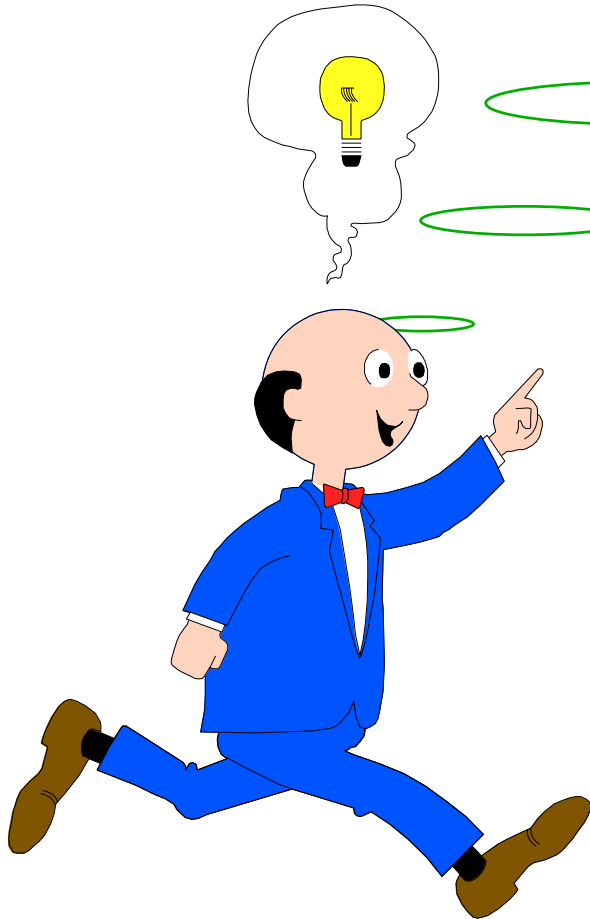
3. Identify Key Buying Criteria

- »»» Identify the priority determining needs for each decision-maker at each level
 - »»» design specific market research to collect missing data (often it is useful to use trade-off analysis and to include some open questions, plus some questions on behaviour)
 - »»» use data from available market studies to deliver insight into customer needs, behaviour and priorities;
 - »»» collect direct customer input through interviews conducted by your staff (**spend a day in the life of the customer**);
 - »»» gather internal knowledge and opinion of customer needs and behaviour;
 - »»» hypothesize, use your imagination
- »»» Look for unmet, poorly met and unidentified needs



Make the Segments Meaningful

Meaningful **CUSTOMER BENEFITS**
Your Company can Deliver



**Unidentified or
Unmet Needs**
BEHAVIOURS
NEEDS

Purchasing Approach
Decision Making Unit
Application
Industry
Geography
Product



Why Segment by Need?

»»» To create a marketing mix we must understand what drives buying decisions

Needs/ Behaviour/ Benefit tells you

WHY PEOPLE BUY?

»»» You must find the differentiating or delighting benefits

4.1 Discover Segments

- »»»» Group customers with similar needs or behaviour
 - »»» profile segments according to needs and behaviour;
 - »»» identify typical customers in each segment;
 - »»» unmet and poorly met needs are the best opportunities to take a marketing initiative, either to sustain leadership or to take a leading position in a market segment

- »»»» Populate segments
 - »»» assign customers to segments until you have accounted for at least 80% of demand for your own and competing solutions
 - »»» calculate size and growth of segment



Target Segment/Opportunity Profile

- »»» Segment Name: COMMITTED
- »»» Segment Profile: customers who want to continue to use chlorinated solvents (e.g. Chlorine Cleaners Ltd.)

- »»» Segment Needs
 - »»» Unmet or poorly met
 - »»» more supportive information from producers to explain safety in use of chlorinated solvents
 - »»» Determinant
 - »»» demonstrated support from producer, regular contact, regular updates
- »»» Critical Success Factors
 - »»» convince their customers of the safety of chlorinated solvents
- »»» Segment Potential: US\$ 3MM Your Company
Share: 30%



How many segments?

- »»»» Segmentation is a basis for CHOICE
- »»»» Do not worry about how many segments you identify (even if it is hundreds)
- »»»» You will choose from the identified segments the ones which you can serve best and most effectively
- »»»» You will target the segments where you believe that you have or can create a competitive advantage - a point of differentiation
- »»»» You will focus your marketing attentions on the chosen segments and de-emphasize activity in the non-target segments

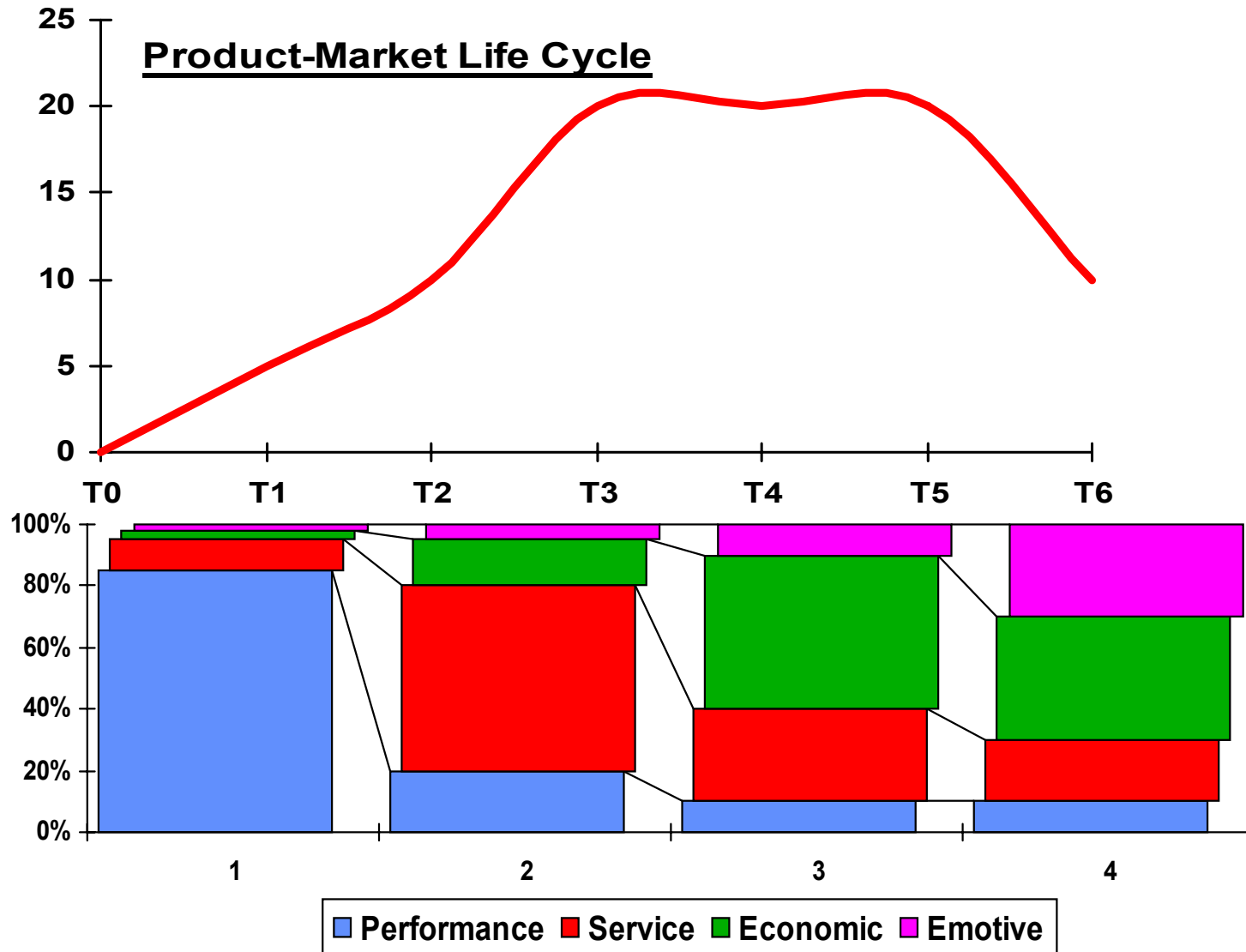


5. Validate Segments

- »»» Can customers be assigned into the segments?
- »»» Do they fit clearly into one segment?
- »»» Can all customers be assigned into segments?
- »»» Are the segments different?
- »»» Can you choose target segments?
- »»» Can you create meaningful offerings for each segment?
- »»» Would customers respond positively to those offerings?
- »»» Try it out

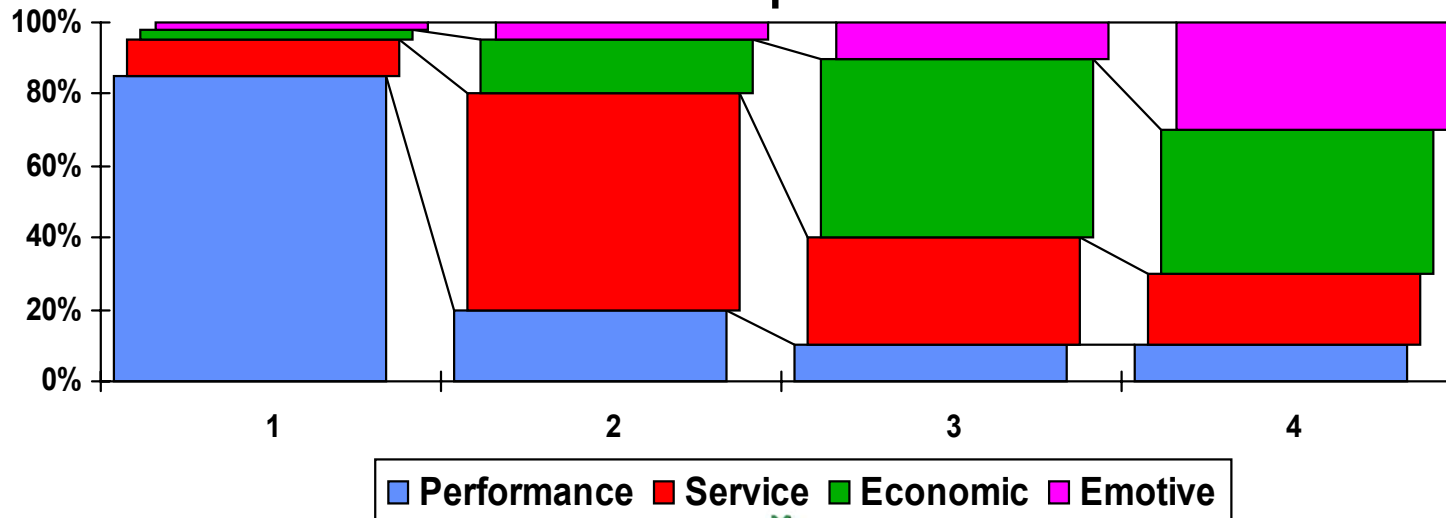


Needs Change Over Time



Anticipate Changing Customer Value

- ▶▶▶▶ We must measure and track customer needs regularly
- ▶▶▶▶ Our tracking and measuring tools must enable us to anticipate changing needs
- ▶▶▶▶ Changing needs will impact our segmentation and will cause us to change our Value Proposition and marketing mix
- ▶▶▶▶ We must beat our competition to take the advantage



Key Steps in Market Segmentation

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- »»» what are the key determining needs for each decision-maker in order of priority in the buying/ supplier selection decisions?
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»»» 4. Discover Segments

- »»» at each relevant level in the value chain, group customers with similar needs or behaviour

»»» 5. Validate the Segments

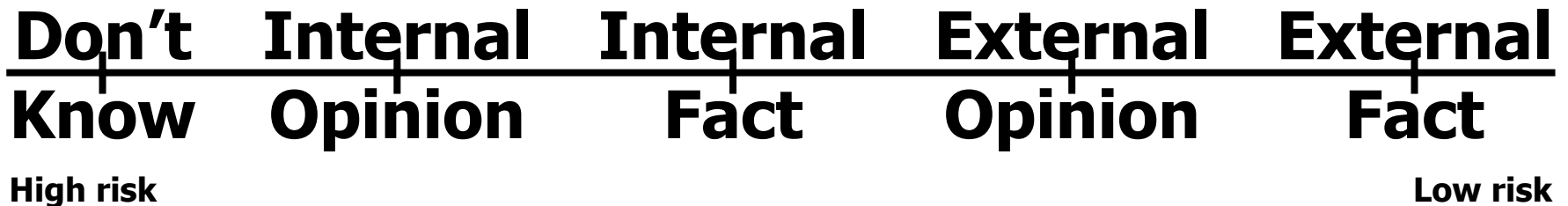
- »»» do the segments make sense, fit your knowledge of the market?



Quality of Knowledge Reduces Risk

»»» Whether we have market research data or not, what is important is the quality of our knowledge

»»» The MarketAbility Knowledge Meter



»»» The higher the quality the lower the risk



Using Market Research

- »»» In order to gain good insights into customer needs and behaviour, it is recommended to use some form of trade-off analysis in the research
 - »» Trade-off analysis
 - »» Conjoint Analysis
 - »» Simalto

- »» Trade-off techniques enforce a choice in the customer, thereby replicating a more realistic perspective on the actual choice situation



Dry and Metal Cleaners Segments

COMMITTED

- Well informed
- Committed to using CS
- Unlikely to phase out or to use alternative
- **Most likely to use client product**
 - Dry cleaners
 - Germany, Sweden
 - Italy, Spain, France

STRUGGLERS

- Less well informed
- Find it difficult to comply with laws and regs.
- Fairly unlikely to use alternative/phase out of CS completely
- **Likely users of client product**
 - All non man./some manual
 - Dry and metal cleaners
 - Italy, Spain, UK

COMPLACENT

- Less well informed
- Few problems to comply
- Use of alternatives or use of client solution = possible options, but no real need
- **Some potential for client product**
 - Dry cleaners
 - Some manual
 - France
 - Spain, Belgium

SWITCHERS

- Well informed
- Find it difficult to comply
- Not committed to CS
 - = likely to use alternative/phase out CS completely
- **Little potential for client product**
 - Metal cleaners
 - Belgium, Netherlands
 - UK, Sweden



Target Segment/Opportunity Profile

- »»» Segment Name: COMMITTED
- »»» Segment Profile: customers who want to continue to use chlorinated solvents (e.g. Chlorine Cleaners Ltd.)
- »»» Segment Needs
 - »»» Unmet or poorly met
 - »»» more supportive information from producers to explain safety in use of chlorinated solvents
 - »»» Determinant
 - »»» demonstrated support from producer, regular contact, regular updates
- »»» Critical Success Factors
 - »»» convince their customers of the safety of chlorinated solvents
- »»» Segment Potential: US\$ 3MM Our Share: 30%



Target Segment/Opportunity Profile

- »»» Segment Name: SWITCHERS
- »»» Segment Profile: customers who are actively seeking alternative technology solutions (e.g. Oxygen Cleaners Ltd.)
- »»» Segment Needs
 - »»» Unmet or poorly met
 - »»» equal or better performing (than chlorinated) safe solutions to dry cleaning
 - »»» Determinant
 - »»» technical support from producer to make their solution work in our equipment
- »»» Critical Success Factors
 - »»» demonstrate product performance; make it work in their machines
- »»» Segment Potential: US\$ 5MM Your Share: 5%



Target Segment/Opportunity Profile

- »»» Segment Name: COMPLACENT
- »»» Segment Profile: customers who think they operate in compliance with regulations, but who do not (e.g. Sloppy Cleaners Ltd.)
- »»» Segment Needs
 - »»» Unmet or poorly met
 - »»» better operating procedures
 - »»» Determinant
 - »»» demonstrate better ways to operate and help them to implement
- »»» Critical Success Factors
 - »»» make customer aware of the need to improve operating procedures, convince them to improve, teach them how, use a credible information source
- »»» Segment Potential: US\$ 8MM Your Share: 15%



Target Segment/Opportunity Profile

- »»» Segment Name: STRUGGLERS
- »»» Segment Profile: customers who would prefer to stay with chlorinated solvents, but who find it difficult to comply with regulations
- »»» Segment Needs
 - »»» Unmet or poorly met
 - »»» understanding of regulations, knowing how to comply, ability to implement
 - »»» Determinant
 - »»» technical advice and support from producer to design and implement compliant solutions
- »»» Critical Success Factors
 - »»» knowledgeable technical and EHS advisors
- »»» Segment Potential: US\$ 9MM Your Share: 28%

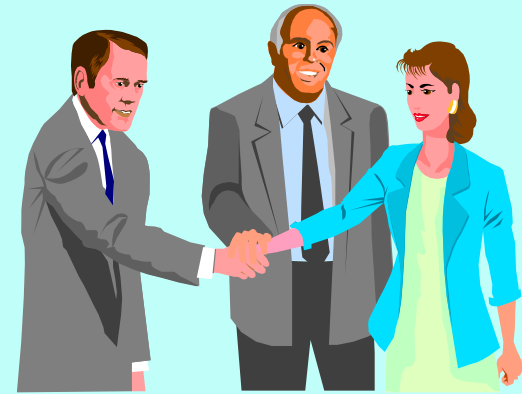


Segment Strategies

SUPPORT THE COMMITTED



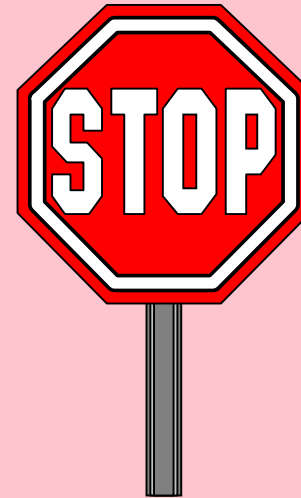
HELP THE STRUGGLERS



EDUCATE THE COMPLACENT



STOP THE SWITCHERS



In the Absence of Market Research

- »»» Use your intimate customer knowledge
- »»» Use internal knowledge about the customer

- »»» Spend a day in the life of the customer (literally)
- »»» Imagine a day in the life of the customer

- »»» Use role playing
- »»» Use your imagination

- »»» Hypothesise customer needs and behaviour
- »»» Validate your hypotheses

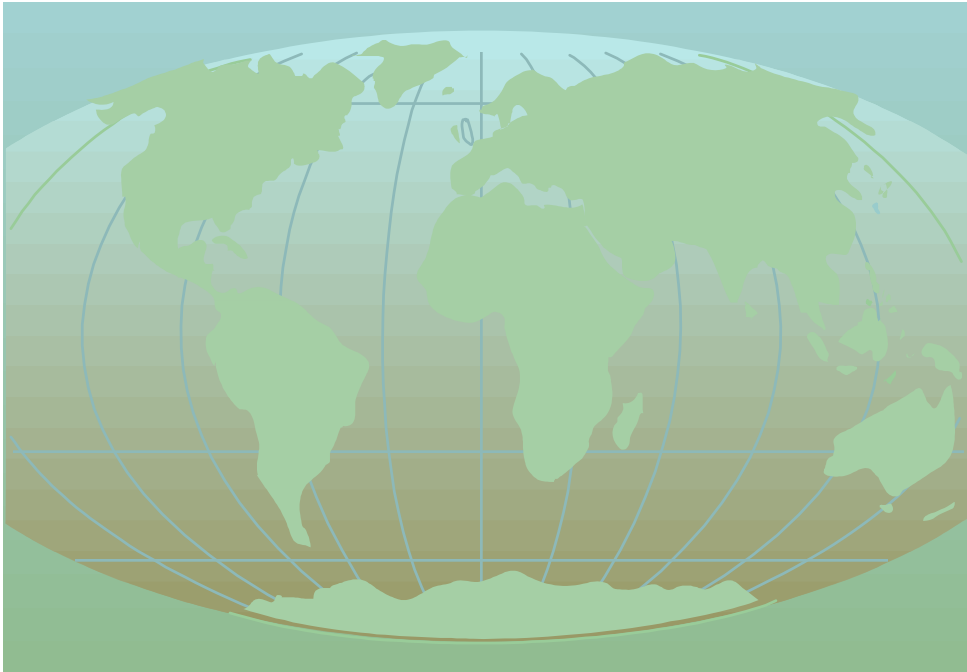


Some Common Pitfalls to Segmentation

- »»» Identifying the end-user
- »»» Obtaining knowledge and understanding of end-user decision-making process and criteria
- »»» Putting yourself in the customers' shoes and seeing it from their perspective
- »»» Being objective about your company's position versus competition (especially, how the customer sees it)
- »»» Not believing that you can quantify segments
- »»» Developing an approach to segmentation that accepts frequent change to segments
- »»» Giving up because it's too hard



**“Every person takes the limits
of their own vision**



for the limits of the world”

Arthur Schopenhauer, German philosopher



Segmentation Matrix Step 1: an Example – Gas Stations (Customer Groups)

WHAT? / WHERE? WHO?	Super- market sites	On urban roads	On major roads	On freeways
Truck Drivers			Preliminary Segment 1	
Professional Drivers				Preliminary Segment 2
Public Services		Preliminary Segment 3		
Private Motorists		Preliminary Segment 4		



Segmentation Matrix – Step 2: an Example (Applying Needs)

Needs	Preliminary Segment 1	Preliminary Segment 2	Preliminary Segment 3	Preliminary Segment 4
Application 1		*	*	*
Application 2		*	*	
Application 3	*			*
Application 4	*		*	