Lessons Learned in Market Segmentation

A Perspective on the Design And Implementation of Market Segmentation Strategies

Lessons Learned

Call it regional marketing, target marketing, micro marketing, niche marketing, one-on-one marketing, or plain old market segmentation. For most business firms, locating and specifically targeting unique market segments is both a reality and a necessity in today's competitive market place. In North America, the assumptions of the mass market no longer hold true for most businesses and product categories. Indeed, in a recent article in *Marketing Management*, marketing guru Fred Webster questioned whether a sustainable mass market every existed in North America. He further argued that the mass market is the exception rather than the rule in most developed economies. The reason is simple – different product and service category users have different needs, thus different demand functions.

Creative and actionable market segmentation strategies often afford the business organization a strategic advantage over their competition. If a firm can address its markets by way of a creative new vision of how that market is structured and operates and can uncover the needs and wants of the segments therein, then it has the opportunity to act on that vision to enhance its own profitability, often at the expense of the competition. It is no secret that foreign firms often enter a domestic market by segmenting the market, uncovering an under-served niche, and then concentrating their marketing and financial resources into that niche. Once established, and often dominating in that niche, those market invaders use their dominant position in the niche as a base of operations to expand into and penetrate other segments.

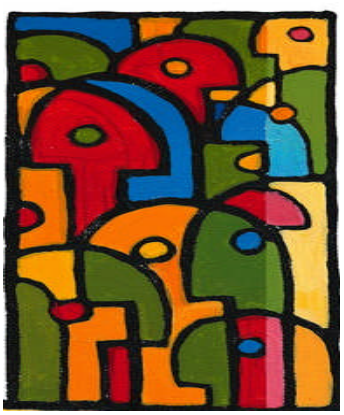
Most firms in North America do some type of market segmentation. Many of those firms use a segmentation basis that is convenient – demographics, SIC codes, or category spending amounts. These segmentation schemes are seldom optimal – that is, they do not adequately differentiate purchasers based on their varied demands for product category performance.

The best market segmentation schemes are based on market research of purchasers and potential purchasers in the product or service category. However, market segmentation research poses unique challenges.

- Truly actionable results are particularly difficult to achieve in segmentation research without careful planning and forethought.
- There is no such thing as a significance test that tells you when you got it right.

- More than in any other research application, different business objectives may lead to very different conceptual approaches, interviewing methodologies, analytic techniques, etc. Hence, there is no single best approach to segmentation.
    - Consumer segmentations have different dynamics than B-2-B segmentations.
    - Multi-cultural (or multi-country) segmentations require different approaches than single-county segmentations.
    - Exploratory segmentations use different techniques then predictive segmentations.
    - Multidimensional segmentation schemes provide different insights than unidimensional segmentations.
    - Products are segmented differently than product users, which are segmented differently than usage occasions.

These are just a few of the complexities of good segmentation research, and they illustrate just how important it is to be clear about objectives and expectations when starting a segmentation program. Segmentation schemes are often deceptively easy to develop – but the results can be stunningly useless if the developer fails to recognize the complexities or simply applies a standard analytical scheme.



That is why many researchers say that segmentation is as much art as it is science. While there is much truth in this statement, it falls short of the whole picture. More than any other research enterprise, good segmentation requires not only technical savvy but also category knowledge, business acumen, a strong sense of organizational dynamics, good judgment, and a certain amount of guts and stamina.

The fact is that all markets have segments with different wants and needs. ***Companies that are successful in uncovering these segments and delivering products and services tailored to specific segments have been able to achieve uncommonly strong results in the marketplace.*** But doing market segmentation well is never easy. Based on more than 30 years of experience doing segmentation work, SDR Consulting has identified certain practices that are often associated with successful segmentation programs:

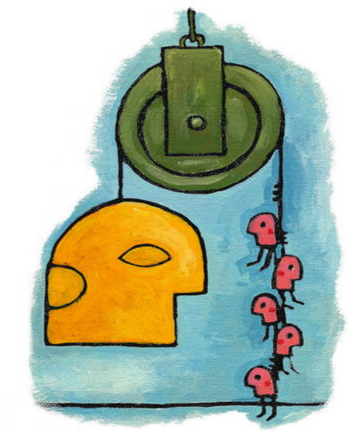
✳ **Segmentation is treated as a marketing strategy rather than a research project.** As noted above, market segmentation is a strategy for driving business growth. Often, but not always, a market segmentation strategy entails conducting a market research study.

Many companies have been quite successful pursuing market segmentation strategies that were not based on a market research-type segmentation study. Examples of these types of segmentations include:

- Channel segmentation
- Geographic segmentation
- Frequent shopper/traveler programs

Senior Management champions the strategy and the process. Since a successful segmentation is both a reflection of corporate strategy and one of the major inputs to corporate strategy, it is essential to have full senior management support. This also implies that senior management needs to be closely involved in the development process.

Too often market segmentation studies are designed and executed at research staff levels and do not include the strategic mandates of senior management.



The segmentation process balances research approach and implementation. Problems often arise when the segmentation merely is an artifact of an analytical technique and is not aligned with strategic objectives. The most actionable segmentation is rarely the same solution that is analytically optimal. ***To be successful, you must "begin with the end in mind" and always be thinking about implementation.***

A successful segmentation will probably impact many different areas of the company. Some examples:

- **Product development** – Products should be designed specifically for a particular segment rather than some "average" customer or consumer. A good segmentation uncovers the different needs each segment has in your product category. Successful implementation of the segmentation strategy involves tailoring new offers to fit the unique needs of target segments.

- **Sales** – Segmentation provides the kind of powerful knowledge and insights that Sales can use to drive business, and can be the cornerstone or starting point for a category management strategy. It also provides important guidance into product mix and pricing decisions. For salespeople to effectively use segmentation, however, it must be developed and communicated in a way that Sales can master and customers can understand.

- **Information Technology** – Segmentation can often have surprisingly far-reaching IT impacts. For example, segmentation can sometimes provide the organizing principle behind the way the company organizes its web site. Many computer companies set up their websites with completely different areas, product offerings, and pricing by segment. Another example: an electric utility built separate needs-based segmentations for its residential and business customers, then scored all of its customers in its data warehouse using a neural network model. In this way they were able to use segment membership as a tool for understanding customer needs and reporting business performance.

- **Market research** – Obviously the research department has to be ready to infuse the segmentation worldview into every piece of research. This means building a practical means of identifying the segment membership of future respondents, and having the resources to target research by segment and analyze by segment.

Key stakeholders buy in. ***More than in any other market research activity, it is absolutely critical to get the key organizational constituencies involved in the process early and often.*** One obvious reason is that the individuals who need to execute strategy in the marketplace need to have a place of ownership of the content and process. People tend to buy in more readily to something they helped create. There needs to be careful planning about how to engage stakeholders, make their knowledge and experience part of the process, share results, and work with them on putting the segmentation into action.

The resident knowledge of the firm is part of the segmentation. Most companies already know a lot about the markets in which they compete, and yet start the segmentation process as if they were starting from scratch. Companies instead should start the process by using the knowledge the firm already has in hand. A key benefit of this process is that it forces companies to catalog what they already know, so that they can be sure to confirm and expand their knowledge in the course of the study rather than just plowing the same ground all over again.

Few researchers recognize that most segmentation techniques can and perhaps should be used in a confirmatory fashion. Knowledge-driven segmentations are almost by definition more actionable than exploratory segmentations. In knowledge-driven segmentation (sometimes called hypothesis-driven or confirmatory segmentation), the first step in the process is to define the major segments believed to exist in the marketplace. This hypothesized segmentation should be as complete as possible, including descriptions of the size and composition of the groups.

The next step is to collect and analyze information that will operationalize these segments. This means creating and/or identifying specific questions or items in a survey or database that can define the hypothesized segments. These items feed into the analytic approach in the form of "seeds" – like suggested starting points – for the algorithm to try to build segments around. If the hypothesized segments exist, the algorithm will end up with a solution similar to the seeds. If things look very different, then some or all of the segments may not exist in the market.

This is not to say that exploratory segmentations have no place, because they sometimes reveal important insights that may have been overlooked by the company. Starting with a clean slate and letting the data and the algorithm find segments, new and unique segments can be identified.

In many cases, both knowledge-driven and exploratory segmentations should be developed and evaluated. This approach provides the fullest understanding of the market and can often yield the benefits of both approaches.

The segments derived from the process are significantly different in terms of their response to changes in the marketing mix. The most frequent grievance with segmentation schemes is their lack of "actionability". The primary reason is that "actionability" was never considered in the up-front design of the segmentation research.

The most basic step to ensure actionability is to continuously test segments for measurable differences in response to marketing mix variables – after all, those are the most obvious actions an organization will take. But it is equally important to identify additional, less obvious, action-items during the planning and design phase.

A consumer packaged goods company used this principle to its advantage in a segmentation designed to guide product development for entry into a new subcategory. A key objective was to identify segments based on product and usage needs, but the key was to also understand which segments would be most receptive to the type of value proposition they could deliver.

By incorporating a measure of the appeal of various aspects of their value proposition into the study, they were able to evaluate segments and segmentation solutions based not only on their needs profile, but also on the relative appeal of the value proposition to that segment.

Segmentation is based on an appropriate alignment of basis variables and segmentation technique. Some segmentations are based on measuring everything there is to measure about a consumer or customer and then segmenting based on a combination of attitudes, behaviors, usage patterns, occasions, demographics, etc. Not only is it typically difficult to derive well-differentiated segments on these mixtures of basis variables, but also there are also technical problems with this approach.

Different measures lend themselves to different segmentation techniques and analytical procedures. One cannot take full advantage of the optimal array of techniques when too many different measures are included in a single segmentation scheme. One solution to this problem is the development of a multi-dimensional segmentation scheme.

Often the best way is to do separate segmentations for each type of basis variable, and then combine them in a multidimensional model. ***A market segmentation based on multiple dimensions, using separate segmentation schemes for each one, is often more useful and more flexible for planning marketing strategy, developing new products, and executing marketing tactics.***

Three dimensions are typical, though the same may apply for two dimensions as well. As a practical matter, four dimensions make the model too complex to be implemented effectively, and so it is best to pare down to two or three. The dimensions can be any basis variables that are pertinent to the objectives of the study.

Suppose that the three segmentation dimensions are:

- Purchase behavior,
- Wants and needs, and
- Revenue potential

The three segmentation dimensions form a cube, and a single cell in the cube represents the intersection of a behavior-wants/needs-revenue group, and consumers in that cell can be completely described in terms of: (1) Value based purchase behavior, (2) their wants and needs, and (3) their revenue potential, and any other attitude/marketing information gathered in the questionnaire.

The power of this segmentation scheme is that cells can be aggregated into specific market segments based on the varying needs of different internal functional and departmental users while using a common base of homogeneous cells for all of the segmentation methods within the company. For instance:

- Product/service developers can have their own segmentation scheme based on "needs" criteria for cell aggregation (i.e. segments).
- Product/service marketers may have another segmentation scheme based on a different framework.
- Corporate branding or communication managers or pricing groups can have their own segmentation scheme based on their specific frameworks.

Even though each of these user groups has distinctly different needs, each of their segmentation schemes can be directly related to each other because they all use a common base of homogeneous cells.

Some benefits of this approach are that it:

- Provides a unified view of different core markets while respecting the key nuances of each,
- Provides a high level of flexibility for development of various products and services,
- Is relevant and usable by all marketing, sales, product development, and market planning constituencies within the company,
- Is actionable in terms of target marketing and sales efforts at all levels of the organization,
- Increases management usability by offering the opportunity to dynamically define target segments with any one, two, or all three dimensions, depending on management or program service needs, and
- Can be tied directly to a consumer/prospect database to enhance targeted direct marketing and relationship building efforts.

The right variables or dimensions drive the segmentation. While this may seem obvious, it is surprising how many segmentations are based on variables like attitudes or lifestyles, which rarely correlate well with response to changes in marketing mix. A segmentation strategy based on the wrong basis variables will never be actionable, and may be quite harmful.

A food manufacturer spent several years and hundreds of thousands of dollars on several pricey segmentations based on attitudes and/or barriers to product usage. None of them revealed why certain consumers used the category and others did not, nor did any of them show significant differences between segments in term of category usage.

They later changed gears and used occasion-based segmentation, using behavioral data on one axis and occasion need-state information on another, to reveal large differences in product usage that depended on situational factors. ***Occasion-based segmentation opened up a new avenue of understanding about the category and the type of products they needed to develop to grow their business.***

Of course no company ever nails all of these success factors in a single effort. Still, knowing the best practices and pitfalls can provide a tremendous leg up when starting a new segmentation initiative and increase the odds of success. And success in segmentation often leads to success in the market place.

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