



White Paper

Customer Segments for Marketing

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Why segment?

A segment can be defined as

"A group of individuals or organisations with characteristics in common that have significant implications for the determination of marketing strategy"¹

The method(s) used to arrive at the segments, together with the segments themselves, are often referred to as a *segmentation model*.

Segmentation is at the heart of marketing theory and effective practice because it allows:

- identification of cohesive and differentiated groups of customers and needs
- tailoring of the marketing mix to address different groups
- emphasised differentiation, segment by segment
- development of better offensive and defensive strategies against competitors
- more effective and efficient use of resources.

...effective segmentation helps organisations serve their customers more effectively, increase sales and reduce unit sales and marketing costs.

In essence, effective segmentation helps organisations serve their customers more effectively, increase sales and reduce unit sales and marketing costs. For this reason, while different terms may be used (eg sector, niche market, micro-segment, micro-niche...) the concept of segmentation is a given in the work of most business thought-leaders².

Critically, segmentation provides the foundation for selecting target markets and so underpins the development of business and marketing strategy.

"Successful entrepreneurs segment their markets even if they don't know they're doing it."

Segment Users

Potential users of the segmentation model in an organisation include:

- sales
- marketing
- corporate/strategic planning
- new product development/R&D
- contact centre
- customer services

Each of these groups has different needs that must be taken into account in developing the segmentation model.

¹ Adapted from David Jobber, "Principles and Practice of Marketing", McGraw Hill

² EG Michael Porter "Competitive Strategy" 1980, Free Press; "Competitive Advantage: Creating and Sustaining Superior Performance" 1985, Free Press

Operational Considerations

Usefulness

There are many approaches to segmentation that will provide insight into market needs and customer attitudes and behaviour. However, insight is not enough: an effective segmentation model must provide the organisation (and its constituent parts) with a *useful* way of viewing the market, ie one that delivers the benefits sought (see above).

This means:

- segments must be *measurable*, eg they should be capable of being sized and their value tracked
- they must also be *addressable*, that is to say they should be sufficiently differentiated through useable criteria to allow sales and marketing resource to be targeted on them

As the market changes so the segmentation model needs to be continually validated and refreshed...

Implementability

The results of a segmentation exercise need to be *actionable*. Addressing newly identified segments is likely to require the reallocation of sales and marketing resources at the least, and may need significant changes to organisational structures. These implications need to be taken into account at the planning stage and buy-in sought from all parts of the organisation likely to be affected. Board-level sponsorship is highly desirable for strategic segmentation exercises.

The depth to which segmentation is conducted also needs to reflect the level at which its results are likely to be actioned. So for example the global product development group of a company manufacturing very high value data network switches may only work to a very high level, simple segmentation model, eg:

Company Size	Company Type	
	Telcos	Corporations
Fortune Global 100	Segment T1	Segment C1
>2,500 employees		Segment C2
1,000 - 2,499 employees	Segment T2	Segment C3
250 - 999 employees		Segment C4
50 - 249 employees		
<50 employees		

Table 1: Simple Segmentation Model for a Product Development Group

The sales and marketing organisation of same company may require several, much more sophisticated, segmentation models, region by region.

Maintenance

Any segmentation model is just that, a model. That is to say it is a representation of the market. As the market changes so the segmentation model needs to be continually validated and refreshed as required.

Some organisations undertake resegmentation as a matter of course, with this forming part of their overall business planning process. This can happen annually or, in some very fast moving markets, quarterly. The advantage of this approach is that the segmentation model is kept up to date and the organisation can continually refocus resource. This approach requires a commitment to ongoing investment and the management of frequent change.

Other organisations track changes in the market through research and only resegment when they feel the existing model is no longer valid. This avoids investment in major resegmentation projects which may generate results little different from what already exists. However, there is a risk that tracking research and sales feedback may not pick up on changing market dynamics quickly enough. This can lead to new segments being addressed ineffectively and so lead to loss of share to competitors.

Approaches to Segmentation

Fundamentals

...the classical approach may not be practical in all cases

Essentially segmentation involves identifying two types of information about customers and prospective customers. The first type is information of any kind that characterises their needs, attitudes, perceptions and/or behaviour. For the purposes of this paper we will group these together as *behavioural attributes*.

In a classical segmentation exercise people/companies are first of all grouped by their similarity in terms of behavioural attributes. These groups then need to be described in terms of identifiable information (eg characteristics that can be identified through databases or readily ascertained through marketing or sales activity). These characteristics are referred to as *profile attributes*. The differentiation between types of attribute is often not as clear cut as this suggests, and the segmentation process is more complex as a result.

There is another reason why the classical approach may not be practical in all cases. Many B2B (business-to-business) organisations have large sales and marketing structures in place to deal with customers based on their size and industry (vertical market segment/sector). The reason is that these profile attributes are easily identified and provide a basic, ready-made segmentation model. In these instances the requirement may be to identify areas of differentiation in the behavioural attributes of the extant segments, rather than identify new segments.

A particular variant of this is to segment the organisation's customer base by value as measured by factors such as lifetime value (LTV) and profitability. These value segments are then profiled and the resulting profiles used to try to attract new customers with similar characteristics.

The attributes selected for segmentation purposes will depend on what the organisation believes is necessary to succeed and on the ability of the organisation to make use of the resulting detail.

The growth in CRM (Customer Relationship Management) databases illustrates both the desire of organisations for an increasing amount of

detail about their customers, and in many cases their inability to make use of it.

This brings us back to the requirements for any segmentation, that it should be:

- measurable
- addressable
- actionable

Consumer Markets

Profile variables for consumers include demographic factors (eg age, sex, life-stage), and socio-economic variables (eg educational level, income, social class). Geographic location (from country down to post code level) is also sometimes used as a factor in its own right, although geographic differences are often a reflection of other factors such as differing average income levels.

... most organisations have found it necessary to adopt more sophisticated segmentation models in relation to their business customers

In consumer segmentation exercises a very wide range of behavioural variables can be used. These will usually include straightforward information, for example around purchase behaviour (when, where, how...) and product usage (occasional, light, heavy...). It is also common to try to identify more sophisticated information, for example in terms of the benefits sought by the customer through the purchase. As well as the purely functional these are likely to include 'soft' benefits such as status, security or convenience. It is also common to include psychographic variables in consumer segmentation models. For example personality type (introvert/extrovert...) or lifestyle/self-perception.

The importance of these 'soft' benefits cannot be over-stressed. De Chernatony and McDonald suggest core product elements such as features, functionality, price and design account for only 20% of its impact, with the product surround (elements ranging from pre- and post-sales service through to corporate image and reputation) accounting for the remaining 80%³.

Organisational Markets

Most organisations selling business-to-business (B2B) have historically used very basic segmentation models. These are usually based on organisation size, industry (vertical sector) and location as much because these characteristics are easy to identify as for any differentiation they allow.

However, as competitive pressures have increased most organisations have found it necessary to adopt more sophisticated segmentation models in relation to their business customers. Most industries have examples of organisations with apparently dominant market leadership positions that have been toppled by competitors initially gaining a foothold in an under-served segment.

The principles of segmentation for organisational markets are essentially the same as for consumers, but the profile factors and behavioural factors differ. For example the key profile factors tend to

³ Leslie de Chernatony and Malcolm McDonald, "Creating Powerful Brands", 1992, Chartered Institute of Marketing/Butterworth-Heinemann

be size, vertical sector and location. Behavioural factors taken into account will now often include:

- choice criteria (eg price conscious vs performance conscious)
- the nature of the decision making unit (eg centralised vs decentralised)
- the purchase process (eg some organisations may place large annual orders with a number of suppliers selected from an approved list, others may allow departments to place orders on an 'as needed' basis).

Consumer techniques are also now seeing their echoes in organisational market segmentation. For example corporate culture can be seen as analagous to psychographic variables and indicators for characteristics such as 'innovation' and 'risk aversion' are often now be included in B2B segmentation exercises.

Data

... senior company managers rarely ask questions about the data...

Segmentation models are built using data. It is an obvious corollary that the effectiveness of any model is heavily dependent on the breadth and quality of the data used in its construction. Yet senior company managers rarely ask questions about the data upon which they will make fundamental strategic decisions.

Broadly speaking, data can be obtained from existing internal or external databases (secondary data/research) and/or through market research (primary research). Data mining techniques are then used to analyse the data and develop the segmentation model(s).

The more comprehensive and representative the range of data sources used, the likelier it is that the model will provide an accurate reflection of the market. Weighed against this is the cost of accessing external data sources and of primary research in particular.

	Internal	External
Customers	Databases - accounting/billing - operations - CRM/sales - web site - customer service - partners (?)	Databases - company registration data (eg revenues, no. of employees, profitability) - off the shelf data - syndicated/omnibus survey data
Prospects	Databases - CRM/sales - contact management - web site - partners (?)	Market research - qualitative (focus groups, face-to-face, telephone) - quantitative (web/permission-based email, telephone, face to face)

Table 2: Potential Data Sources

It should be stressed that data to be used for segmentation purposes must be obtained in line with the letter and spirit of data protection regulations applying in each territory included in the exercise. This must be taken into account in the planning stages of the segmentation exercise, for example when developing a segmentation model in one country that may be rolled out in others where the use or availability of data are more restricted.

Databases

The first place to look for useful data is the organisation's own databases. This has the advantage of ready availability and comparatively low access cost. However, internally held data is often of poor quality with a high proportion of incomplete, duplicate or out of date records - studies show that in many large organisations as much as 80% of basic customer information (such as contact name, address and telephone number) is inaccurate.

If the business operates through different channels, such as direct sales, distributors, and retail outlets, then each of these will have information and records relating to customers. If the circumstances allow, these can be a valuable source of additional information. Co-ordinating these and enabling them to make use of segment information is a challenge for any business.

Once an audit of internal data has been completed to understand the range and quality of what is available, external databases can be investigated. There are many vendors of databases and lists, and the quality of data varies widely. Before an order is placed it is important to conduct an assay on a random sample of data. Most reputable vendors will provide such a sample as specified by the purchaser, for example the first 50 records with the company names beginning with a particular letter.

The data available from extant databases is usually insufficient to provide a basis for anything other than basic segmentation. It is also sometimes possible to participate in syndicated or omnibus surveys which allow access to data regularly collected on a range of customer behaviours and characteristics, but these are usually too non-specific to build a segmentation model of use to any single organisation. To provide rich, accurate and current data for segmentation purposes, primary market research is usually required.

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Market Research

Qualitative Research

Qualitative research often means using focus groups or in-depth interviews, though other methodologies may also be used. In-depth interviews with a sample taken from different sections of the population, and with key people, such as opinion formers and those with specialist knowledge, is a common approach.

It is particularly useful at the beginning and at the end of the segmentation process. At the outset it can be used to develop and/or test hypotheses about possible segments and the factors likely to provide the greatest differentiation between them. However, it usually cannot be used on its own to build the segmentation model because of the limited number of people contacted. It may provide

a biased view of the population as a whole. In particular, it will not give any indication of the size of the segments, or of what drives each segment to make a purchase decision. To do this quantitative research is required.

Once quantitative research has been completed and clear segments have been identified further qualitative work might be conducted to 'get under the skin' of particularly interesting segments, or to gain a full understanding of key segment differentiators.

Quantitative Research

The purpose of quantitative research is to provide a solid and statistically representative set of data for analysis and thence segmentation

The purpose of quantitative research is to provide a solid and statistically representative set of data for analysis and thence segmentation. The size of the sample required depends upon the size of the market (the research 'universe'), the likely number and size of the segments and the accuracy (usually measured in terms of statistical confidence) required. It is a misapprehension that large samples are required for useful analysis: in the UK (adult voting population ~46 million) general election opinion polls are normally conducted with a weighted sample of only ~1,000 people with a quoted accuracy of ~+/-2%.

As a general rule larger samples are of benefit where there is likely to be a requirement to profile sub-segments. This is simply because a large overall sample gives a greater chance that the sample for a sub-segment will be big enough to provide statistically reliable results.

To be useable for analysis the data generated need to be in a numerical form. There is considerable skill involved in putting together questionnaires that ask the right questions in the right way, and this should be handled by specialists. Open responses can also be captured and coded for analysis subsequently although this is resource intensive, and so tends to be expensive. Such responses can also be used to add colour to the analysis through illustrative quotes.

Quantitative research techniques include web, permission-based email and telephone surveys. Where questions may need explanation, or respondents need to look at stimulus material (eg pictures of different products) face-to-face interviews may be appropriate.

Analysis

Anyone with one of the standard statistical software packages can use the cluster analysis option to produce segments. Whether it will mean anything is another matter.

The commonly used approach is to assume that every customer falls neatly into a single category as shown in the example in Figure 1.

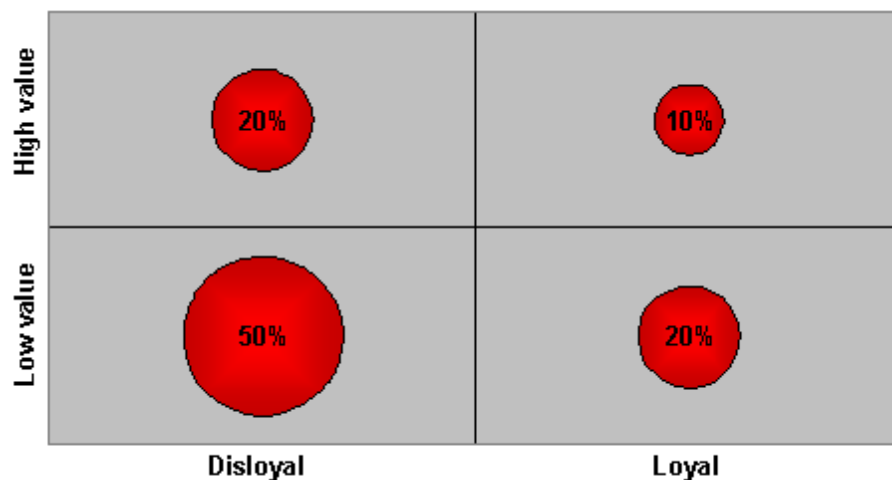


Figure 1: Simplistic view of segment allocation

Most people are in the middle...

In reality, the situation is more like that shown in Figure 2. Most people are in the middle, and we identify the characteristics of those who are more in one direction than another.

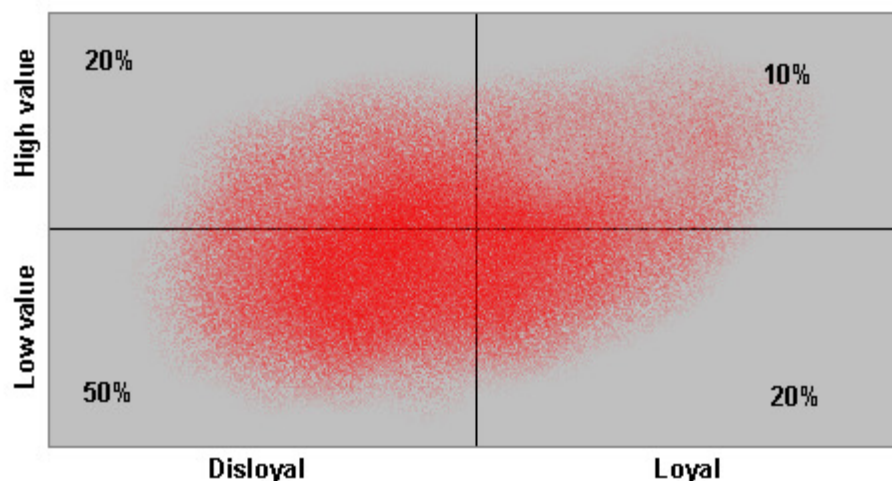


Figure 2: More realistic view of segment allocation

What is needed is to be able to calculate the extent to which each individual has a tendency in any particular direction. This is multi-dimensional segmentation.

When done properly, the analysis will identify those characteristics which best differentiate customers, eliminate characteristics that do not add further information, and seek to select groupings of characteristics that have a meaning both in the business and in the marketplace.

This will usually involve a selection from the following multi-variate and data mining techniques:

- Factor analysis
- Discriminant analysis
- Conjoint analysis
- Decision trees
- Cluster analysis

Note that cluster analysis is only a final step which is used to simplify the results for business use.

The result is a profile that contains, for any individual, a set of values giving the tendency of that individual to fall into each category.

Using Segments

The specific way the segments will be used should have been largely decided at the planning stage

Effective segmentation provides validated customer segments that can be used for all the purposes described in 'Why segment?' at the beginning of this paper. They can be aligned with marketing and sales channels, and the characteristics of each segment can be described not only in terms of their profile characteristics, but behavioural characteristics.

The specific way the segments will be used should have been largely decided at the planning stage. Where they will be used in conjunction with a sales or marketing database, the business needs to decide whether the database should be updated with segment details on a periodic basis or should be updated continuously.

Updating the database periodically means that the results of the segmentation analysis will be applied to the latest version of the database. As each new customer or prospect is added, there is no method of assigning segment information. It is usually worthwhile repeating the whole research process on a regular basis, so that adjustments can be made to the segmentation, and new segments can be uncovered where these emerge within a developing marketplace.

If the database is to be updated continuously, this means that new customers and prospects will be assigned segment information whenever they are processed for a marketing campaign or other activity. The downside is that this involves a much more complex IT system, which may have to be implemented as part of the organisation's CRM (Customer Relationship Management) system.

Customer Profiles

Customer profiles are one of the key outputs of segmentation. Where these are to be held in a sales or marketing database, they will contain values which measure the affinity of each person to a segment. The values must be capable of being inferred from the data that is already held in the database.

The process involves creating a statistical model which maps the characteristics of the segments onto the pieces of information that are in the database. Ideally this should be done by someone with both the analytical skills and a business understanding of the particular marketplace.

From a marketing point of view, it may be necessary to turn the segments on their heads. This is done by deciding the segments and channels that can be used in practice, and by calculating the affinity of each target group to the segments that have previously been discovered.

This illustrates the power of the profile. Because the profile contains the affinity to each segment, rather than a simple allocation to a single segment, the business is able to apply the segmentation to its existing sales and marketing processes.

Presenting/Describing the Segments

It is important to convey to the business users the richness of customer profiles and how these relate to the segments. Showing how the segment affinities can be applied to familiar sales and marketing processes will illustrate this.

The segments themselves will have been constructed to correspond to what the business users will recognise. This will have been done by involving them throughout so that they have a sense of ownership of the results.

In order to gain understanding, business users will need to be presented with the segments as distinct groups, rather than as parts of a continuous spectrum. This simplified view might be considered to be a dangerous distortion. However, business users need to be able to remember the segments and their characteristics easily, and this can only be done by giving them a life and personality. This is often helped by developing catchy names for the segments.

About Wright Associates

Founded in 1994 Wright Associates is a management consultancy firm offering support to senior executives lacking the time or resource to deal with critical issues as fast as they would like. Our clients range from corporates to SMEs and start-ups. We work across business sectors with a particularly strong track record in technology, media and services. Our services are grouped into focus areas:

- Go to market
- Decision support and planning
- Sales performance
- Africa solutions
- Organisational support

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