

## Slaying the Mythical Beast: The Role of Segmentation

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## Outline

- Overview of Segmentation
    - The Marketing Philosophy
    - Definition and its Uses
  - Value of Segmentation
    - Why Segment
    - Segmentation in Action
    - Vocabulary of segmentation
    - Criteria for segmentation
  - Segmentation and the Firm
    - Impact on Firm Strategies
    - Evolution in Segmentation
- Q & A

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## Average Joe

*Traditionally we characterized the market by the needs of this mythical creature.*

*Who or What is this? Does this beast exist?*

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## Where do we go from there?

- Need a More Useful Message:
  - Ex: A Drink for the Average Person--Tea for Two!
  - Impact on Firm's decisions.
    - We make (Lukewarm Tea) tradeoffs everyday.
- We are all not satisfied/excited by the same things.
  - Mindset Challenge: Get rid of the "Average Joe"
  - One Size doesn't fit all
    - ❖ Ford's Model T only in black.
    - ❖ Product Differentiation to the rescue!
    - ❖ "Some like it hot, ... in the pot nine days old"

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## Management Tools and Trends

- Bain & Co. 2005 Global Survey:
    - 960 surveys from international executives.
    - Investigated most popular tools and techniques. Tool had to be:
      - Relevant to senior management; Topical; and Measurable
  - Results:
    - CRM and Customer Segmentation identified as the top 5 tools.
    - "...continuing widespread use of customer segmentation, which divides existing and prospective customers into discrete groups that share certain characteristics."
    - "Some 72% of companies relied on segmentation in 2004, tying it for fifth in popularity; its satisfaction score, at 3.97, is tied for fourth highest..."
    - Executives are becoming more customer-centric
- [http://www.bain.com/management\\_tools/2005\\_tools\\_strategy\\_brief.pdf](http://www.bain.com/management_tools/2005_tools_strategy_brief.pdf)  
[http://www.bain.com/management\\_tools/Management\\_Tools\\_and\\_Trends\\_2005.pdf](http://www.bain.com/management_tools/Management_Tools_and_Trends_2005.pdf)

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## An Early Halloween

- Major Theme (Bain Survey, 2005)
  - "Consumer is in Control"
  - "this is scary for many organizations."
- Executives feeling they do not know enough about their customers:
  - Two-Thirds surveyed said: "insufficient customer insight is hurting our performance"
- Effective Marketing Strategy requires:
  - Identifying Segments for developing targeted products and services.

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### Slaying the Mythical Beast: Segmentation to the Rescue

Employing a process of dividing a heterogeneous market into homogenous subsets of customers -- or segments.

➤ **I.e., dividing a market into groups of potential buyers who have similar**

- needs and wants,
- value perceptions, or
- purchasing behaviors.

#### Segments

**Members are different between segments but similar within.**

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### Value of Segmentation: Why Segment? Why Bother?

- ⇓ Customers differ in their **needs** for a given product.
- ⇓ They will therefore **react** differently to different product offerings.
- ⇓ It follows that a firm can achieve greater profits by
  - ⇓ **developing products and marketing programs for specific segments rather than for a mass market.**

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### Why Segment?

- Aggregation across segments may provide misleading information
- Consumers may be too numerous, widely scattered and varied in their needs and Organizations have limited resources
- Competing organizations may be better able to attract certain groups of customers (segments) in the market
- **Each Organization should, therefore, identify the most attractive parts of the market that it could effectively serve (i.e., Target Market)**

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### Segmentation can be used to:

- ⇓ **Identify Target Markets for Direct Mail Campaigns**
- ⇓ **Guide in the Design of New Products**
- ⇓ **Determine appropriate products and promotional campaigns for different groups**
- ⇓ **Assign Customers and Prospects to Channels**

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### Value of Segmentation:

- **Who are our Customers?**
  - Some times even the best firms do not know who they are reaching or even who are purchasing their product!
- **Example: Campbell Soup & Curtis Publishing Co.**
- **Do you know who YOUR customers are?**
  - Are they all 51 year old men?
  - Do all 51 year olds dream the same dream

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### Segmentation in Action: Marriott Hotel

*A Marriott Hotel used to be a Marriott Hotel: An upscale hotel catering to*

***business people, pleasure seekers and international and group travelers.***

*Today, besides the Marriott Hotels, there are*

***Marriott Suites, Residence Inns, Courtyards by Marriott and Fairfield Inns***

*—Each serves a **smaller, targeted segment** of the market.*

—Lenneman and Stanton, "Mining for Niches," *Business Horizons*.

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**Any HOGS here?**



**Vocabulary and Bases of segmentation**

**Bases**—characteristics that tell us why segments differ (e.g., needs, preferences, decision processes).

**Descriptors**—characteristics that help us find and reach segments.

(Business markets)	(Consumer markets)
Industry	Age/Income
Size	Education
Location	Profession
Organizational structure	Life styles
	Media habits

**Basis of Segmentation: Geographic**

- Geographic
  - Region (Pacific Northwest, Atlantic,...)
  - Climate (warm, cold...)
  - Population density (urban, suburban, rural)
- Examples:
  - Campbell Soup makes:
    - Nacho Cheese Soup spicier for Texas and California markets
    - Cream of Chile Poblano for Mexico; Peppery Tripe for Poland; Watercress and Duck Gizzard for China
  - Ski products are not sold at near equator.
  - How about Coca-Cola?

**Basis of Segmentation: Behavioral**

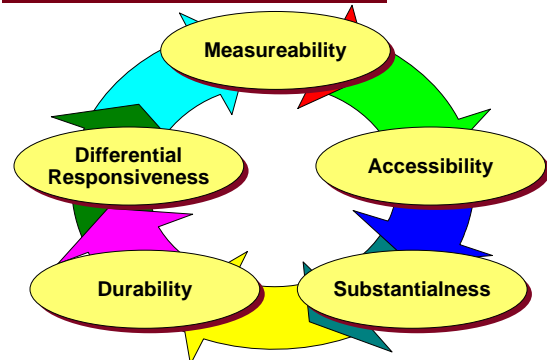
- Buyer thoughts and feelings
  - Attitudes (positive, neutral, negative)
  - Benefits sought (convenience, economy, prestige)
  - Readiness stage (unaware, aware, informed...)
  - Innovativeness (early adopter, laggard,...)
- EX:
  - Crest by Procter and Gamble offered the benefit of anticavity protection
  - Airlines: Business and Pleasure Travelers
    - Business: Reliability; Convenient Schedules; Easy-to-use airports; comfortable service
    - Pleasure: Price; feasible schedules

**Basis of Segmentation: Usage**

- Purchase behavior
  - Usage rate (light, medium, heavy)
  - Source loyalty (purchase from one, two, three or more suppliers)
  - User status (non-users, ex-user, potential user...)
- EX:
  - Buy Online: from Amazon.com, Soma.com: Affiliate
  - 41% of the sampled households buy beer. But heavy users accounted for 87% of the beer consumed.
    - A beer company would prefer to attract one heavy user to its brand rather than several light users.

✦ Journal of Consumer Marketing (1984)

**Criteria for Effective Segmentation**

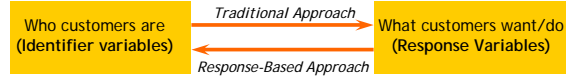


## Unhappy Segmentation

- ❑ Traditional Segmentation Approach:
  - ❑ Customers into groups that **look the same** on Background variables (demographics, firmographics, etc.).
  - ❑ **Then**, hope to discover meaningful differences in what they **want and need**.
- ❑ We have known (for a while):
  - ❑ Tastes and Purchasing patterns are not neatly aligned with Demographics
    - ❑ Frank, Massey and Wind (1971)
  - ❑ A call for Non-Demographic segmentation
    - ❑ Yankelovich (HBR, 1964)

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## Response-based segmentation: Putting the horse before the cart



- Traditional ("A Priori") Segmentation Approach:
  - Start by dividing customers into groups that **look the same** on identifier variables (demographics, psychographics, etc.). *Work forward, hoping to discover meaningful differences in what they want and need.*
- Response-based ("Post-Hoc") Segmentation Approach:
  - Start with groups of customers who have similar needs and benefits and respond similarly to marketing variables. *Work backward to see if the groups can be identified based on differences in demographic or firmographic variables.*

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## A Reminder

- ❑ Clustering in general is a hard problem.
  - ❑ *Non-Hierarchical, Non-Overlapping, Disjoint Clusters*
  - ❑ # of Customers = N; # of Clusters = K
  - Potential partitions =

$$P := \sum_{i=1}^N \frac{(-1)^{(N-i)} N! i^K}{i! (N-i)!} \quad \text{Weisstein (2003)}$$

❑ Approximately  $P := \frac{K^N}{K!}$  Kaufman & Rousseeuw (1989)

- ❑ N=50, K=3 => P= 10<sup>^23</sup>; N=100, K=4 => P= 10<sup>^58</sup>
- ❑ Complete Enumeration is impossible
- ❑ Heuristics needed

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## The Life & Death of K-Means

- ❑ Good News:
  - ❑ MacQueen's (1967) Algorithm
    - ❑ Iterative Procedure; Popular; Easy to Use; Efficient;
    - ❑ SAS; SPSS; SYSTAT, etc...
- ❑ Is it All That it is Cracked up to be?
  - ❑ Does not guarantee Global Optimum;
  - ❑ Depends on the starting seeds;
  - ❑ Seed Replacement Procedure; etc...
  - ❑ Steinley (2003); Hartigan & Wong, 1979; MacQueen, 1967; Milligan (1980);
  - ❑ Better Heuristics; Integrated Heuristics
    - ❑ Kuo, Chang & Chien (2004); Balakrishnan et al (1994, 1996)
  - ❑ Not easy to use on the DOS Problem.

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## Cases for not Conducting Segmentation

- ☞ When the market is small
- ☞ When the brand is dominant in the market
- ☞ When heavy users make up such a large proportion of the sales
- ☞ When you already know what you are going to do – Organizational realpolitik!
- ☞ When Targeting could be criticized as unethical. Two key factors:
  - The perceived harmfulness of the product
  - The perceived vulnerability of the target

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## Caveat: Ethical Issues in Segmentation

- Heileman's PowerMaster Malt Liquor
- Malt liquor was mainly consumed by blacks and low-income neighborhood
  - PowerMaster was 31 % stronger than Heileman's Colt 45, which was the market leader, and had 65 % more alcohol than regular beer
- Caused uproar among anti-alcohol groups and black leaders  
Black men had a 40 % higher death rate from cirrhosis of the liver than did whites
- Asked brewer to stop distribution by saying "Higher octane alcoholic beverages have no place on the market, especially in communities where residents already suffer disproportionately from alcohol and other drug problems"

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### Segmentation and the Firm: Impact on the Firms' Strategies

Organize the Company along: Product Lines or Customer/Business Segments.

- Product organization requires understanding everything about all types of consumers.
- Thorough understanding the unique Needs and Behaviors of each customer needed to serve them better.
- How they use the product and how they buy differs => different Sales organizations might be required.

**Key Idea: "Divide and Conquer"**

### Example of Segmentation

Segmentation and Michael DELL

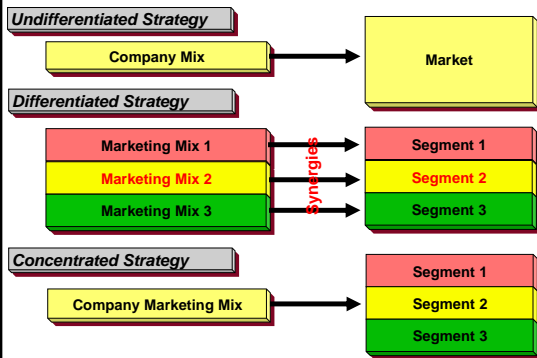
#### ✓ Newspaper Subscriptions

- Cold calling Not effective.
- Purchase highest for
  - Newly married and New Home Owners
  - Get data from County on Marriage Licenses & Mortgage lists.

#### ✓ Response to DELL Computer Ads

- Germans not comfortable with telephoning in response to an Ad.
- Too forward! But are willing to Fax in their information and have the salesperson call them.
- Requires: Modification of strategy to account for cultural differences!

### Segmentation Strategies



### Firm Strategies:

**Segmentation  $\iff$  Product Differentiation**

Moral: A company must be willing to differentiate its products to meet the demand of each customer segment.

- Honda differentiated Accord (U.S. vs. Japan)
    - Type U.S. (The roomiest of all, has V6 engines)
    - Type Japan (Smallest of all)
  - In Europe, Electrolux varies its household appliances according to national taste and customers.
    - Offers 120 basic refrigerator designs with 1,500 variants. Larger for Northern Europe (shop once a week), smaller for the south; Freezers on the bottom in the north; on top in the south; UK -- freezers may makeup 60% of the space.
- Niche Marketing:
- Imperial Broom Co.: Brooms for African-American Weddings -- "jumping the broom" ceremony.

### Evolution in Approaches to Serving Markets

Approach	Description	Examples
<b>Mass Marketing</b>	A single marketing mix for the entire market	Phone service, WEB pages
<b>Segment marketing</b>	A single marketing mix for one segment of the market	Women's Workout World (exercise facilities for women); American Association for Retired Persons
	Separate marketing mixes for two or more segments of the market (Possible Synergies)	McDonald's (Happy Meals for young children, Big Macs for Teens, Arch Deluxe for adults); Xerox copiers (several sizes and features to meet different levels of business needs)
<b>Individual marketing</b>	A marketing mix customized for an individual or organization	Personalized amenities for repeat guests at Ritz-Carlton hotels; <u>Customized</u> WEB pages

### Summary Remarks

- Don't fall prey to the myth of the average consumer.
  - Remember that 2.1 kids don't exist!
  - Look alikes don't necessarily think alike!
- Customers' are all NOT alike in their Needs.
  - "Some like it hot, Some like it cold, ... in the pot nine days old" => One Size doesn't fit all.
  - Your Employees are the frontline in this Intelligence gathering; understanding evolving preferences.
- Use needs variables to segment markets.
  - Use Descriptors to find them.
- Select segments taking into account both
  - the attractiveness of segments and
  - strengths of the firm.

### **Summary Remarks**

- Not all Segmentation schemes are meaningful or useful.
  - **Be prepared to test them.**
- Need to be willing differentiate the offerings to different segments
  - **"peas porridge hot, peas porridge hot ..."**!
- Not all Segments need to be served.
  - For Employees: Need to recognize the need to build distinct products and services for each customer segment,
  - Accounting: Must investigate profitability of each of the segments.
  - Firm: From a revenue standpoint recognize there may be large behavior-driven cost differences with each group.
- Develop mechanisms to implement the segmentation strategy on a routine, evolving basis.
- Ultimate Segment is of Size One.
  - **one way to do this is through information technology.**
  - **MyIdea.COM**