# MARKET SEGMENTATION by Emeritus Professor Malcolm McDonald

## Introduction

The purpose of this paper is to explore the role of market segmentation in the domain of marketing. After fifty years, market segmentation is still at the heart of successful marketing. This paper is in three parts. The first part attempts to summarise the author's scholarly research into market segmentation. Because of space problems, the first part is necessarily brief. The second part is a practitioner-oriented view of how segmentation can be used to ensure success. The third part briefly discusses the future of market segmentation.

<u>A brief history of scholarly research in the domain of market segmentation</u>

The author of this paper did a catholic review of scholarly research into the history of market segmentation (Jenkins and McDonald 1997) in which 36 references were cited. However, due to scale constraints here is a very brief summary of this research.

The father of market segmentation is widely considered to be Wendell Smith (1956) who prepared market segmentation as an alternative to product differentiation. Yet it wasn't until Wind's (1978) review of the state of market segmentation that the topic went to the top of the agenda of researchers and practitioners. His plea was for new segmentation bases, data analysis techniques and for generally putting market segmentation at the heart of strategic decision making.

In 2009, a whole issue of the Journal of Marketing Management was devoted to market segmentation and for those readers wanting an updated literature review, see Bailey (2009) in that issue. They confirm that most of the work over the intervening years has been primarily around what segmentation bases to use, such as size of purchase, customer characteristics, product attributes, benefits sought, service quality, buying behaviour and, more recently, propensity to switch suppliers, with much of this work being biased towards fast moving consumer goods rather than to business to business and services.

In 2002 Coviello and a host of others, with the advent of relationship marketing and customer relationship management, proposed one-to- one as a successor to market segmentation, although Wilson (2002) found that most CRM projects fail because of poor segmentation. Rigby (2002) summed this up succinctly by saying that trying to implement CRM without segmentation is like "trying to build a house without engineering measures or an architecture plan".

Given the amount of academic scholarships and attempts at implementation in the world of practice over the 54 years since Wendell Smith first raised the consciousness of the community to the importance of market segmentation, it is surprising that so little progress has been made. In 2006, <u>Christensen,</u> in the Harvard Business Review found that of 30,000 new products launched in the USA, 85% failed because of poor market segmentation. Yankelovich's paper in 2006 also reported the widespread failure of segmentation initiatives. This matches the author's own research over a 35 year period. His analysis of 3,000 marketing plans revealed that only 300 contained proper needs based segmentation – i.e. 90% didn't.

The author of this paper, having been Marketing Director of a major fast moving consumer goods company and having worked on practical segmentation with senior teams from leading global

multinationals down to SMEs for 35 years, finds much of the academic debate referred to above somewhat arrogant and inward-looking.

The justification for saying this is that anyone who says "we segment markets by ...." is totally missing the point. Any market, once correctly defined in terms of needs rather than products, consists of 100 per cent of what is bought, how it is used and why it is bought and used in these ways. The role of any supplier is to understand these behavioural patterns and to discover their rationale, rather than trying to impose some predetermined segmentation methodology onto the market.

This paper continues by briefly explaining what is wrong with certain existing segmentation methodologies and goes on to outline a market-based method which has worked successfully in every sector in which it has been applied during the past twenty five years. During this period of ten successful doctoral theses, a link between shareholder value creation and excellent marketing was clearly established and this link is shown in the left hand column of Table 1 (for one such thesis, see smith B (2003).

Table 1

| Excellent Strategies | Weak Strategies |
| --- | --- |
| • Target needs based segments | • Target product categories |
| • Make a specific offer to each segment | • Make similar offers to all segments |
| • Leverage their strengths and minimise their weaknesses | • Have little understanding of their strengths and weaknesses |
| • Anticipate the future | • Plan using historical data |

Market Definition

It has become clear after at least seventy years of formalised marketing that market definition and segmentation are the very core of the discipline. For example, correct market definition is crucial for:

- share measurement

- growth measurement

- The specification of target customers

- The recognition of relevant competitors

- The formulation of market strategy

How to measure market share has always been at the centre of controversy in discussions of failure. Defining a market too broadly or too narrowly can both lead to meaningless statistics.

" A market is the aggregation of all products or services which customers regard as being capable of satisfying the same need " Malcolm McDonald ( 2007 )

Companies frequently confuse target markets with products--- pensions or main frame computers for example. This, coupled with a lack of knowledge about the sources of differential advantage in each segment, signals trouble.

Many companies pride themselves on their market segmentation even though these so called "segments" are in fact SECTORS, which is a common misconception.  Everyone with a marketing qualification knows that a segment is a group of customers with the same or similar needs and that there are many different purchase combinations within and across sectors.

But the gravest mistake of all is a PRIORI segmentation.  Most books incorrectly state that there are several bases for segmentation, such as socio-economics, demographics, geo-demographics and the like.  But this misses the point totally.  For example, Boy George and the Archbishop of Canterbury are both As, but they don't behave the same!  Nor do all 18 to 24 year old women behave the same! (demographics) Nor does everyone in my street (geo-demographics) behave the same!

As already stated, all goods and services are made, distributed and used and the purchase combinations that result make up an ACTUAL market, so the task is to understand market structure, how the market works and what these different purchase combinations (segments) are. All schemes such as socioeconomics, demographics, geodemographics and psychographics are clearly very useful at a very high level of marketing. For example,, young marrieds will represent a large group who have needs for furniture, kitchens, carpets etc, but within this substantial group there will clearly be several different need sets known as segments

What causes markets to segment ?

Let us examine the factors that cause markets to break into smaller groups.

.In Western Europe and other advanced economies, most consumers have television, washing machines, cars and the like, so if Ford, for example, want to grow sales, they can no longer rely on the kind of market growth we have all enjoyed since the second world war. Today they have to take sales from a competitor, which means they have to play very close attention to consumer needs and this is where market segmentation comes into its own, as will be explained later.
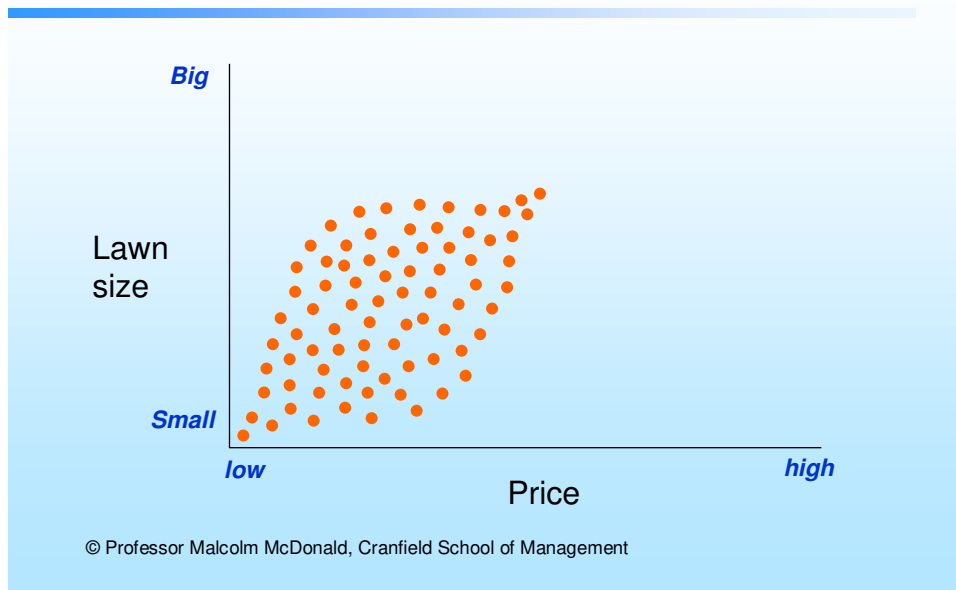
This has been explained in order to introduce the key concept of market segmentation and why it happens. Clearly, in the early days, markets will tend to be homogeneous. But, as demand grows rapidly with the entry of the early majority, it is common for new entrants to offer variations on the early models, as I have just explained and consumers now have a choice. In order to explain this more clearly, let me illustrate the approximate shape of markets. If we were to plot the car market in terms of speed and price, we would see very small, inexpensive cars in the bottom left hand corner (see figure 1). In the top right, we would see very fast, expensive cars. Most cars, however, would cluster in the middle, what we might call: "The Mr. and Mrs. average market."

Figure 1
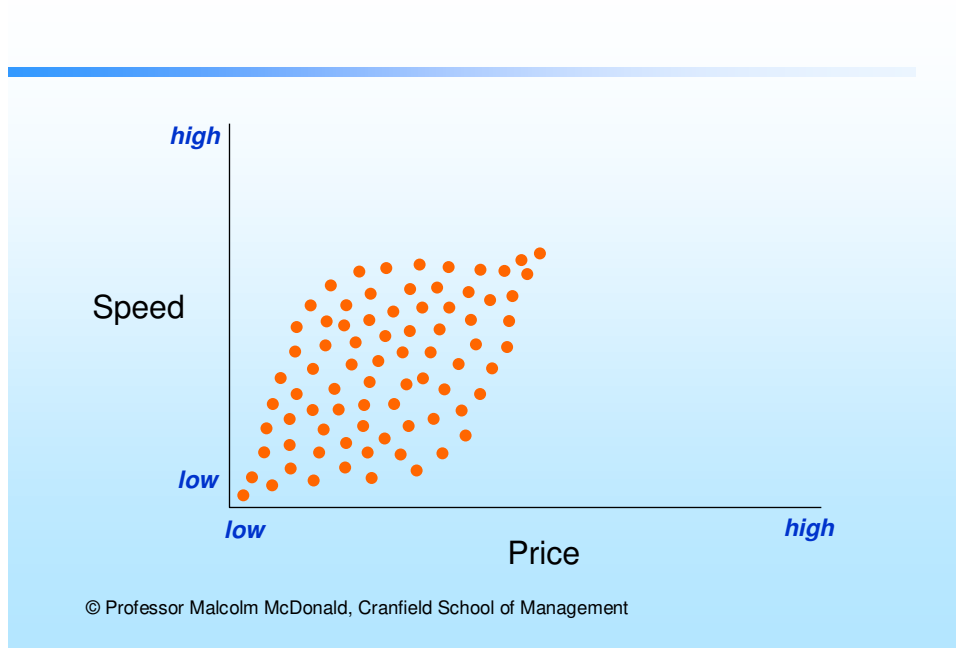
Similarly, the lawn mower market would look very similar (see figure 2). With lawn size on the vertical axis and price on the horizontal axis, at the bottom left would be small, inexpensive, hand pushed mowers, with expensive sit-on machines for large estates in the right hand corner. That leaves the mass of the market with average size lawns, and average sized lawn mowers, which is where the mass market is.

Figure 2

Lawn size (Big / Small) vs Price (low / high)

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We can now redraw this to represent the shape of any market, particularly at the early growth stage (the shape on the left in figure 3). But when rapid growth begins, new entrants joins the market and offer variations on standard products in order to attract sales, and it is at this stage that markets begin to break into smaller groups, while still growing overall (This is represented by the shape in the middle). Eventually, when markets mature, and there is more supply than demand, any market growth tends to come in the lower price end of the market, whilst the top end of the market tends to be immune (This is represented by the shape on the right). It is usually the middle market that suffers at this stage, with many competitors vying with each other on price. This, however, is the whole point of market segmentation, for competing only on price is to assume that this is the main requirement of customers, whereas the truth is that this is rarely the case. It is just that a general lack of understanding about market segmentation on the part of suppliers about the real needs of customers in mature markets, forces them to trade on price, so encouraging the market to become a commodity market.

Figure 3
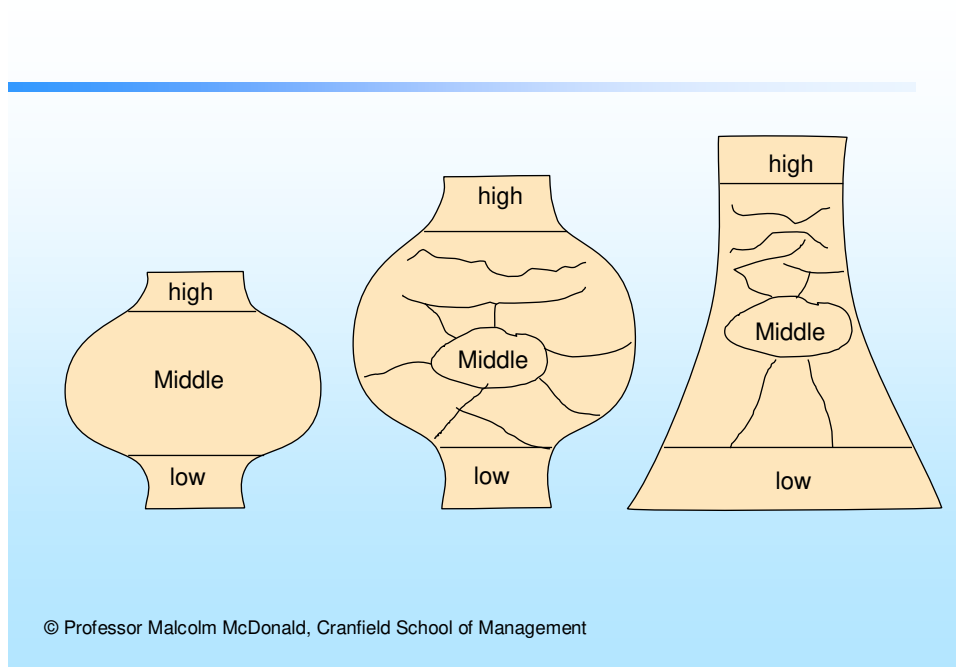
The starting point in market segmentation is correct market definition which is crucial for measuring market size, growth and share, identifying relevant competitors and formulating strategies to deliver differential advantage. Few companies give sufficient attention to correct market definition and few can draw an accurate market map and therefore have little chance of doing anything remotely resembling correct market segmentation at the key influence points or junctions on the map.

At each if these junctions, segmentation is not only possible, but crucial. The methodology for market segmentation is explained fully in the fourth edition of "market segmentation: how to do it; how to profit from it" by Malcolm McDonald and Ian Dunbar ( Wiley 2012) and this process is summarised in this paper.

This process will be expanded on later in this paper, but before this, let us clarify the terminology about customers and consumers.

# The difference between customers and consumers

Let us start with the difference between customers and consumers. The term 'consumer' is interpreted by most to mean the final consumer, who is not necessarily the customer. Take the example of a mother or father who is buying breakfast cereals. The chances are that they are intermediate customers, acting as agents on behalf of the eventual consumers (their family) and, in order to market cereals effectively, it is clearly necessary to understand what the end-consumer wants, as well as what the parents want.

This is only relevant in that it is always necessary to be aware of the needs of eventual consumers down the buying chain.

Consider the case of the industrial purchasing officer buying raw materials such as wool tops for conversion into semi-finished cloths, which are then sold to other companies for incorporation into the final product, say a suit, or a dress, for sale in consumer markets. Here, we can see that the requirements of those various intermediaries and the end-user are eventually translated into the specifications of the purchasing officer to the raw materials manufacturer. Consequently, the market needs that this manufacturing company is attempting to satisfy must in the last analysis be defined in terms of the requirements of the ultimate users – the consumer – even though the direct customer is quite clearly the purchasing officer.

Given that we can appreciate the distinction between customers and consumers and the need constantly to be alert to any changes in the ultimate consumption patterns of the products to which our own contributes, the next question to be faced is: who are our customers?

Direct customers are those people or organizations who actually buy direct from us. They could, therefore, be distributors, retailers and the like. However, as intimated in the previous paragraph, there is a tendency for organizations to confine their interest, hence their marketing, only to those who actually place orders. This can be a major mistake, as can be seen from the following case history.

A fertilizer company that had grown and prospered during the 1970s and 1980s, because of the superior nature of its products, reached its farmer consumers via merchants (wholesalers). However, as other companies copied the technology, the merchants began to stock competitive products and drove prices and margins down. Had the fertilizer company paid more attention to the needs of its different farmer groups and developed products especially for them, based on farmer segmentation, it would have continued to create demand pull-through differentiation.

The segmentation study revealed that there were 7 distinct types of farmer, each with a different set of needs. To give just 3 examples of these segments, ( see figure 4 ). Firstly, there was a segment we called Arthur (the figure at the top of the slide), a television character known for his deals. He bought on price alone but represented only 10% of the market, not the 100% put about by everyone in the industry, especially the sales force. Another type of farmer we called Oliver (the figure in the bottom right of the slide). Oliver would drive around his fields on his tractor with an aerial linked to a satellite and an on-board computer. He did this in order to analyze the soil type and would then mix P, N and K, which are the principle ingredients of fertilizer, solely to get the maximum yield out of his farm. In other words, Oliver was a scientific farmer, but the supply industry believed he was buying on price because he bought his own ingredients as cheaply as possible. He did this, however, only because none of the suppliers bothered to understand his needs. Another type of farmer we called David (the figure in the bottom left of the slide). David was a show-off farmer and liked his crops to look nice and healthy. He also liked his cows to have nice, healthy skins. Clearly, if a sales representative had talked in a technical way to David, he would quickly switch off. Equally, to talk about the appearance of crops and live-stock would have switched Oliver off, but this is the whole point. Every single supplier in the industry totally ignored the real needs of these farmers, and the only thing anyone ever talked about was price. The result: A market driven by price discounts, accompanied by substantial losses to the suppliers. ICI however, armed with this new found information, launched new products and new promotional approaches aimed at these different farmer types, and got immediate results, becoming the most profitable subsidiary of ICI and the only profitable fertilizer company in the country.

Figure 4
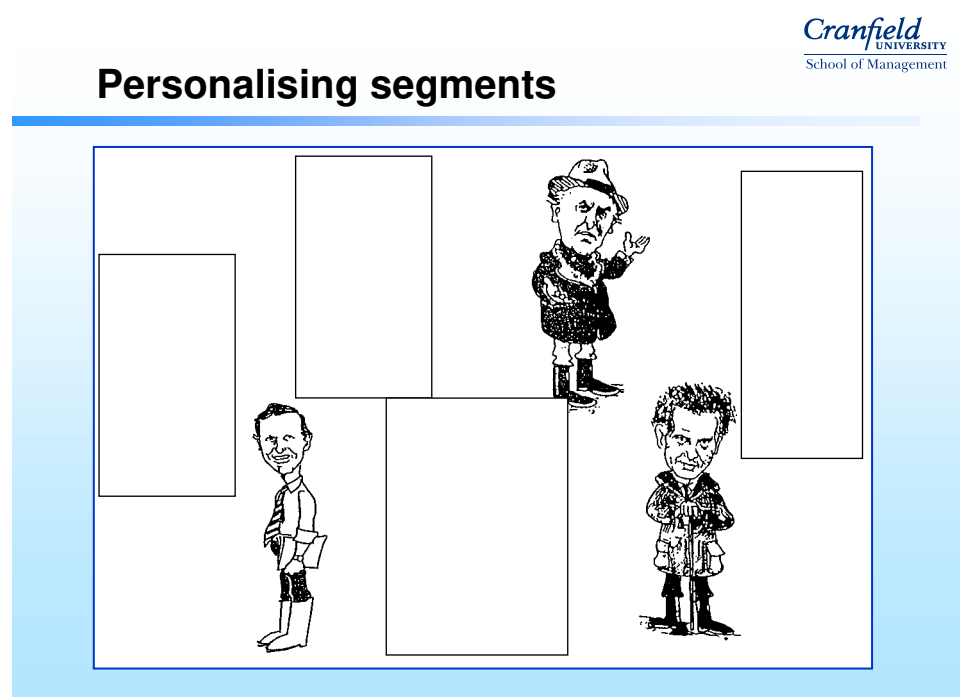
Let us now return to market dynamics and what happens to markets at the rapid growth stage. At this stage, new entrants come into the market, attracted by the high sales and high profits enjoyed by the industry. Let us illustrate this with another case history. In the early 1970s, a photocopier company had 80% market share and massive profit margins. This is represented by the big circle in the middle of figure 5. When a Japanese newcomer entered the market with small photocopiers, the giant ignored them. The Japanese product grew in popularity however, forcing the giant to reduce its prices. Within 3 years, the giant's share was down to 10%, and the battle was lost. They had failed to recognize that the market was segmented and tried to compete in all segments with their main product, a mistake made by hundreds of erstwhile market leaders. The main point about this case history, is that companies should not attempt to compete in all segments with the same product, but should recognize that different segments or need groups develop as the market grows, and that they should develop appropriate products and services, and position and brand them accordingly.

Figure 5



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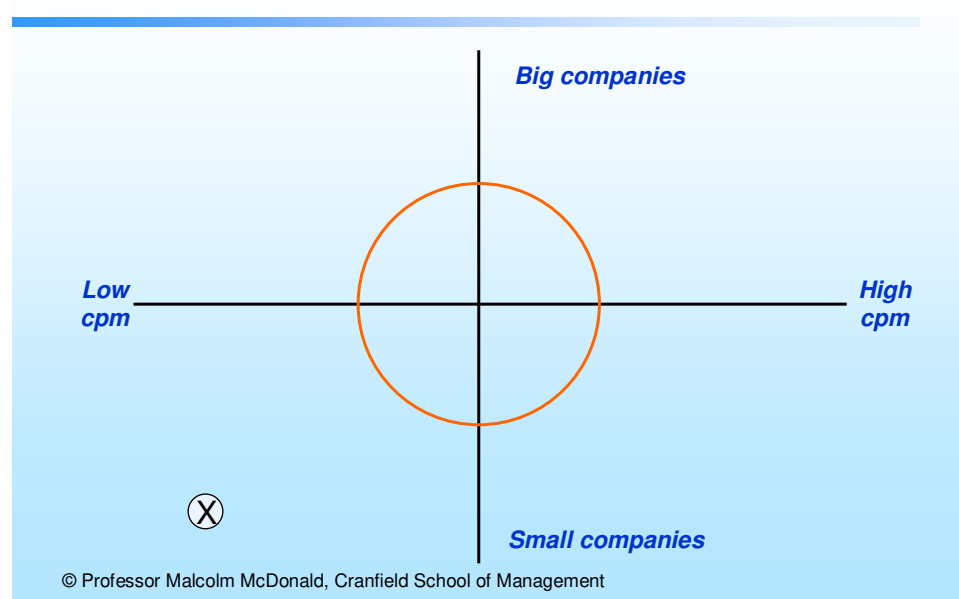
Let us summarize all of this by showing a product life cycle representation with some generalizations about how marketing strategies change over time.      ( see figure 6 ). From this, which we suggest you study carefully, you will see at least four major changes that occur over the life cycle. At the top of the far right hand column, you will see the word "commodity", but the point we want to make is that this is by no means inevitable, and only occurs in markets where the suppliers do not understand the power of market segmentation, as illustrated in the fertilizer case history. There are other options of course, including the option to get out of mature markets. Another is to move the goal posts as it were, somewhat

in the manner of First Direct, Direct Line, Michael Dell, Virgin, Amazon.com, and countless others. The strategy we want to concentrate on here, however, is market segmentation, which in our view, should be the very first consideration as markets begin to mature.

Figure 6

## The product / market life cycle and market characteristics

| Key Characteristics | Unique | Product Differentiation | Service Differentiation | "Commodity" |
|---|---|---|---|---|
| Marketing Message | Explain | Competitive | Brand Values | Corporate |
| Sales | Pioneering | Relative Benefits Distribution Support | Relationship Based | Availability Based |
| Distribution | Direct Selling | Exclusive Distribution | Mass Distribution | 80 : 20 |
| Price | Very High | High | Medium | Low (Consumer Controlled) |
| Competitive Intensity | None | Few | Many | Fewer, bigger International |
| Costs | Very High | Medium | Medium/Low | Very low |
| Profit | Medium/High | High | Medium/High | Medium/low |
| Management Style | Visionary | Strategic | Operational | Cost Management |

An excellent example of good practice is Procter & Gamble in the USA supplying Wal-Mart, the giant food retailer. As can be seen from the simple diagram in figure 7, P & G create demand pull (hence high turnover and high margins) by paying detailed attention to the needs of consumers. But they also pay detailed attention to the needs of their direct customer, Wal-Mart. Wal-Mart are able to operate on very low margins because, as the bar code goes across the till, this is when P & G invoice them, produce another and activate the distribution chain, all of this being done by means of integrated IT processes. This way, they have reduced Wal-Mart's costs by hundreds of millions of dollars.

Figure 7
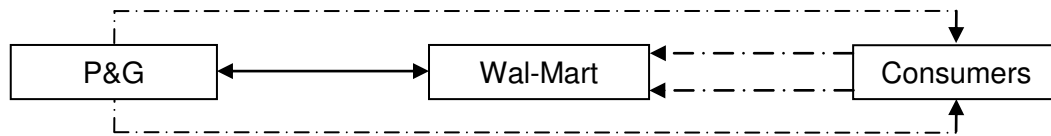
Closely related to the question of the difference between customers and consumers is the question of what the term "market share" means.

## Market share

Most business people already understand that there is a direct relationship between relatively high share of any market and high returns on investment, as shown in Figure 8

Figure 8 - The relationship between market share and return on investment

# Quality and share both drive profitability
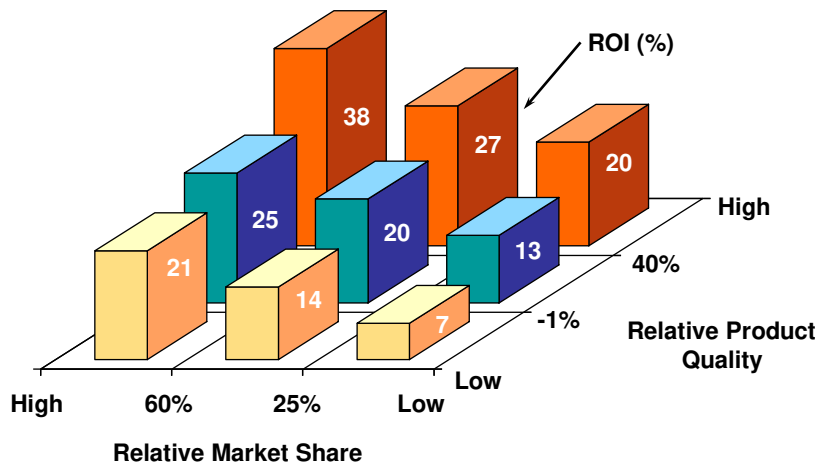


Source: PIMS

Clearly, however, since BMW are not in the same market as Ford, for example, it is important to be most careful about how 'market' is defined. Correct market definition is crucial for: measuring market share and market growth; the specification of target customers; recognition of relevant competitors; and, most importantly of all, the formulation of marketing strategy, for it is this, above all else, that delivers differential advantage.

The general rule for 'market' definition is that it should be described in terms of a customer need in a way which covers the aggregation of all the products or services which customers regard as being capable of satisfying the same need. For example, we would regard the in-company caterer as only one option when it came to satisfying lunch-time hunger. This particular need could also be satisfied at external restaurants, public houses, fast food specialists and sandwich bars. The emphasis in the definition, therefore, is clearly on the word 'need'.

To summarize and to repeat the opening comments in the paper correct market definition is crucial for the purpose of:

- Share measurement
- Growth measurement
- The specification of target customers
- The recognition of relevant competitors
- The formulation of marketing objectives and strategies

# Market segmentation

We can now begin to concentrate on a methodology for making market segmentation a reality, market segmentation being the means by which any company seeks to gain a differential advantage over its competitors.

Markets usually fall into natural groups, or segments, which contain customers who exhibit a similar level of interest in the same broad requirements.

These segments form separate markets in themselves and can often be of considerable size.  Taken to its extreme, each individual consumer is a unique market segment, for all people are different in their requirements.  While CRM systems have made it possible to engage in one-to-one communications, this in not viable in most organizations unless the appropriate organizational economies of scale have been obtained at a higher level of aggregation such as at segment level.  Consequently, products are made to appeal to groups of customers who share approximately the same needs.

It is not surprising, then, to hear that there are certain universally accepted criteria concerning what constitutes a viable market segment:

1. Segments should be of an adequate size  to provide the company with the desired return for its effort
2. Members of each segment should have a high degree of similarity in their requirements, yet be distinct from the rest of the market.
3. Criteria for describing segments must enable the company to communicate effectively with them

While many of these criteria are obvious when we consider them, in practice market segmentation is one of the most difficult of marketing concepts to turn into a reality.  Yet we must succeed, otherwise we become just another company selling what are called 'me too' products.  In other words, what we offer the potential customer is very much the same as what any other company offers and, in such circumstances, it is likely to be the lowest priced article that is bought.  This can be ruinous to our profits, unless we happen to have lower costs, hence higher margins, than our competitors.

There are basically three stages to market segmentation, all of which have to be completed.

The first establishes the scope of the project by specifying the geographic area to be covered and defining the 'market' which is to be segmented, followed by taking a detailed

look at the way this market operates and identifying where decisions are made about the competing products or services.   Successful segmentation is based on a detailed understanding of decision-makers and their requirements.  The second is essentially a manifestation of the way customers actually behave in the marketplace and consists of answering the question 'Who is specifying what?'.

The third stage looks at the reasons behind the behaviour of customers in the marketplace and answers the question 'Why?' and then searches for market segments based on this analysis of needs.

The following sections provide an overview of the steps required to complete these three stages and is presented in a format for conducting a segmentation project using internal resources.

# Stage 1 - Defining the market

The first step in market segmentation establishes the scope of the segmentation project by specifying the geographic area covered by the project and by clearly understanding from a customer's perspective the 'market' in which your products or services are competing with those of your competitors. Where necessary, the scope is modified to take into account the realistic capabilities of your organisation.

A clear geographic boundary enables you to size the market, to identify the localities in which the dynamics of the market have to be understood and, once the segments have been identified, to develop the appropriate marketing objectives and strategies for those localities.

Keeping the project within the borders of a single country is a manageable starting point because the stage of market development, the available routes to market and the pattern of marketing activity will probably be the same throughout the country. Even this, however, may be too broad for some companies, simply because their geographic reach is limited by physical and/or economic considerations, or even because their appeal has a strong local sentiment attached to it.

For companies trading in numerous countries around the world, there is clearly an enormous attraction in finding a single global segmentation model that can be applied to every country. However, the experience of 'globalisation' has highlighted for many of these companies that they have to 'act local' in order to succeed in their market. This doesn't mean that every country is completely unique in respect of the segments found within it. For the international

company, a useful guide to predetermining which countries can be included in a single segmentation project is to ensure that in each of these countries the stage of market development, the available routes to market and the pattern of marketing activity are the same, or at least very similar.

As a reminder, the general rule for 'market' definition is that it should be described in a way which covers the aggregation of all the alternative products or services which *customers* regard as being capable of satisfying that same need.

Table 2 is an example from financial services

**Some Market Definitions (personal market)**

| Market | Need (on-line) |
|---|---|
| Emergency Cash ('Rainy Day') | Cash to cover an undesired and unexpected event often the loss of/damage to property). |
| Future Event Planning | Schemes to protect and grow money which are for anticipated and unanticipated cash calling events (eg. Car replacement/repairs, education, weddings, funerals, health care) |
| Asset Purchase | Cash to buy assets they require (eg. Car purchase, house purchase, once-in-a-lifetime holiday). |
| Welfare Contingency | The ability to maintain a desired standard of living (for self and/or dependants) in times of unplanned cessation of salary. |
| Retirement Income | The ability to maintain a desired standard of living (for self and/or dependants once the salary cheques have ceased. |
| Wealth Care and Building | The care and growth of assets (with various risk levels and liquidity levels). |
| Day-to-Day Money Management | Ability to store and readily access cash for day-to-day requirements. |
| Personal Financial Protection and Security from Motor Vehicle Incidents | Currently known as car insurance. |

# Market mapping

A useful way of identifying where decisions are made about competing products and services and, therefore, those who then proceed to the next stages of segmentation, is to start by drawing a 'market map'.

A market map defines the distribution and value added chain between final users and suppliers of the products or services included within the scope of your segmentation project. This should take into account the various buying mechanisms found in your market, including the part played by 'influencers'.

An example of a generic market map is given in figure 9

Figure 9

## Market mapping

…including the number of each customer type



N   = Number
%   = Your Share

NB. Sketch out complex junctions separately. Alternatively, build an outline map, applying details at the junctions to be segmented.
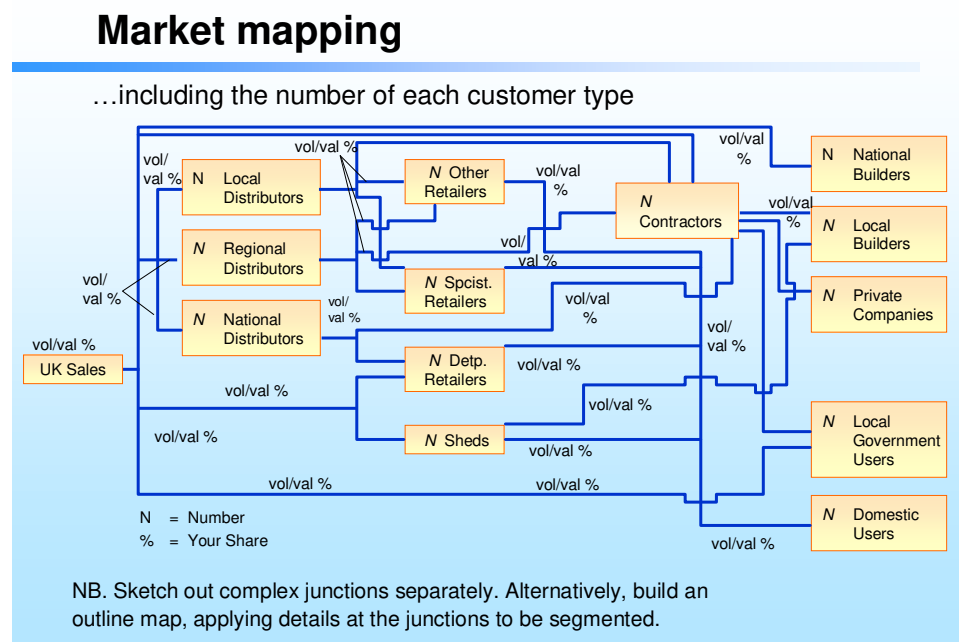
It is useful to start your market map by plotting the various stages that occur along the distribution and value added chain between the final users and all the suppliers of products or services competing with each other in the defined market. At the same time, indicate the particular routes to market the products are sourced through, as not all of them will necessarily involve all of these stages.

Note at each junction on your market map, if applicable, all the different types of companies/customers that are found there, as illustrated in Figure 10

**Figure 10** Market map listing the different junction types

| Final users | | • Households |
| | | • Private companies |
| | | • Government |

| Contractors | | |

| Retailers | | • General |
| | | • Specialists |
| | | • Sheds* |

| Distributors | | • Regional |
| | | • National |
| | | • Local |

| Suppliers | | • The 'big three' |
| | | • Regional independents |
| | | • Other |
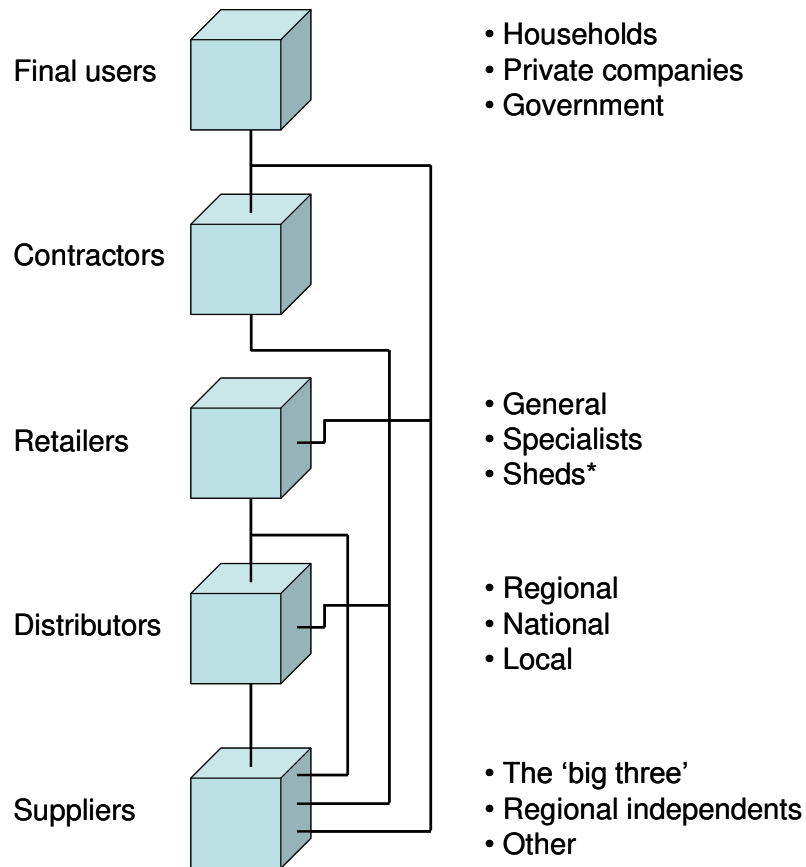
*Note:* * 'Sheds' is the name sometimes used to refer to hardware superstores.

It is useful at this point to split the volume or value quantity dealt with by each junction between the junction types.

This is shown in figure 11

The easiest junction at which to start this page of market mapping is at the final users' junction, noting at each junction with leverage the volume/value (or percentage of the total market) that is decided there. Guesstimate these figures if they are not know and note this as a requirement for any follow-up work generated by this first pass at segmenting your market.

This is also illustrated in figure 11

**Figure 11** Market leverage points on a market map



Final users
300k

Contractors
75k

Retailers
180k

Distributors
105k

Suppliers
300k

% of the total
market decided on

70% decided    210k

*(30% to go)*

20% decided    60k

*(10% to go)*

10% decided    30k

*(0%)*

300k

*Key:* - junction where market leverage is found

1
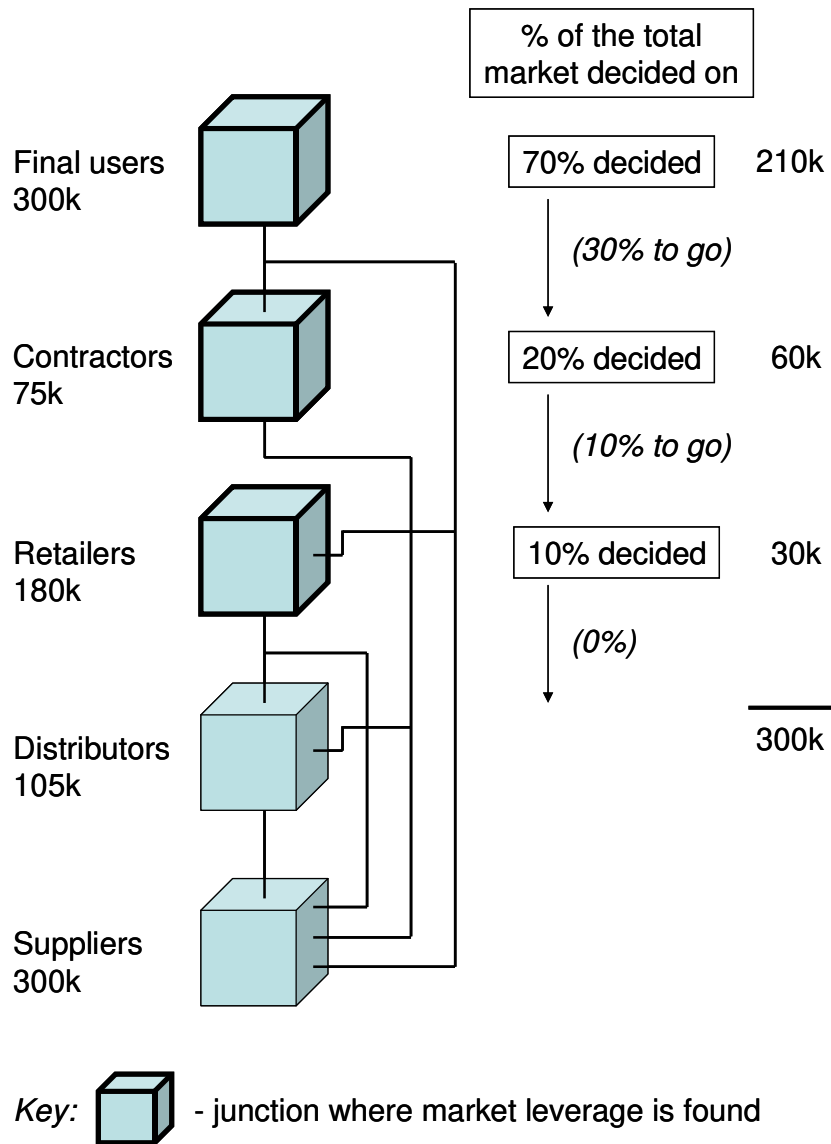
In Figure 11 we see a market in which 30 per cent of annual sales are decided at junctions other than the final user junction.

So far, we have built a market map by tracking the distribution and value added chain found between final users and suppliers, and shown the various routes that are taken through the map to link the two together. We then quantified the map. This was followed by expanding the detail to show the different types of companies/customers found at each junction on the map and these were also quantified.

# Stage 2 - Who specifies what, where, when and how

In this step we are developing a representative sample of different decision-makers which identifies the characteristics and properties of a purchase on which decisions are made along with the customer attributes that will be used to describe the decision-makers. Each constituent of this sample is called a 'micro-segment'.

The uniqueness of a micro-segment is that when determining which of the alternative offers to be bought, the decision-makers it represents demonstrate a similar level of interest in a specific set of features, with the features being the characteristics and properties of 'what' is bought, 'where' it is bought, 'when' it is bought and 'how' it is bought as appropriate to the micro-segment. To this is added the descriptors which describe who the micro-segment represents along with an estimate of the volume or value they account for in the defined market.

The principle behind this step is that by observing the purchase behaviour of decision-makers and understanding the key constituents of this behaviour, we have a platform for developing a detailed understanding of their motivations. It is, therefore, a critical link with the next step of the segmentation process, which looks at why decision-makers select the particular products and services they specify. This, in turn, becomes the basis on which the segments are formed.

The following process chart in Figure 12 describes a number of steps that will now be described.  From this, you will see that the process begins with market mapping, which corresponds to a deep understanding of the market.  This has already been discussed above.

Figure 12

# The market segmentation process

**Stage 1: Your Market and How It Operates**

**Step 1 - Market Mapping**
Structure and decision makers

**Stage 2: Customers and Transactions**

**Step 2 - Who Buys**
Customer profiling

**Step 3 - What is Bought**
Purchase options

**Step 4 - Who Buys What**
Customers and their purchases

**Stage 3: Segmenting the Market**

**Step 5 - Why it is Bought**
Customer needs

**Step 6 - Forming Segments**
Combining similar customers

**Step 7 - Segment Checklist**
Reality check

We can now turn to the process again, and move to steps 2,3,4 and 5, although it must be pointed out that segmentation can and should be carried out at all major junctions on the market map, not just at the final user junction.

Essentially, these time-consuming steps involve listing all purchase combinations that take place in the market, including different applications for the product or service. (see Figure 15 ), principal forms such as size, colour, branded, unbranded etc, the principle channels used, when- such as once a year, weekly, etc., how- such as cash or credit. Next it's important to describe who behaves in each particular way using relevant descriptors such as demographics. For industrial purchases this might be standard industrial classifications, size of firm etc., whereas for consumer purchases this might be socioeconomic groups such as A,B,C1,C2,D and E or stage in the life-cycle, or age, sex, geography, life-styles or psychographics. Finally, and most difficult of all, each purchase combination has to have a brief explanation of the reason for this particular type of behaviour. In other words, we need to list the benefits sought, and it is often at this stage that an organization needs to pause and either commission market research or refer to its extant database of previous market research studies. Although in the figure shown there are only 10 micro-segments, it is normal in most markets for companies to identify between 30 and so micro-segments. Remember, these micro-segments are actual purchase combinations that take place in a market."

Figure 13



## Micro-segments

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| Micro-segment | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|
| What is bought | | | | | | | | | | |
| Where | | | | | | | | | | |
| When | | | | | | | | | | |
| And How | | | | | | | | | | |
| Who | | | | | | | | | | |
| Why (benefits sought) | | | | | | | | | | |

To summarize so far, it is clear that no market is totally homogeneous (see figure 14).

Figure 14

## An undifferentiated market

But one with many different purchase combinations
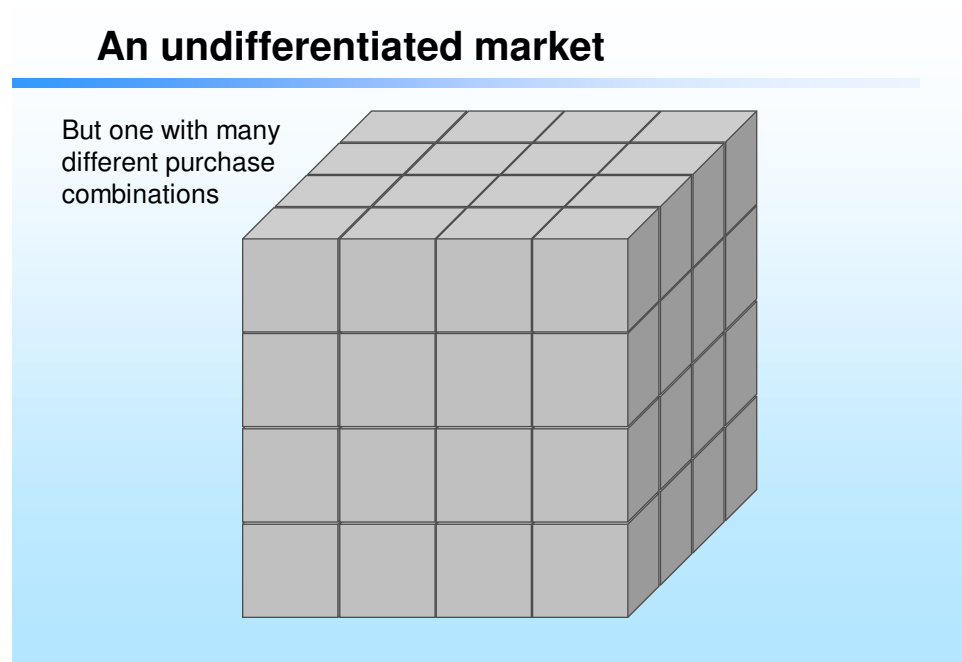
The reality is that actual markets consist of a large number of different purchase combinations (see figure 15).

Figure 15

# Different needs in a market
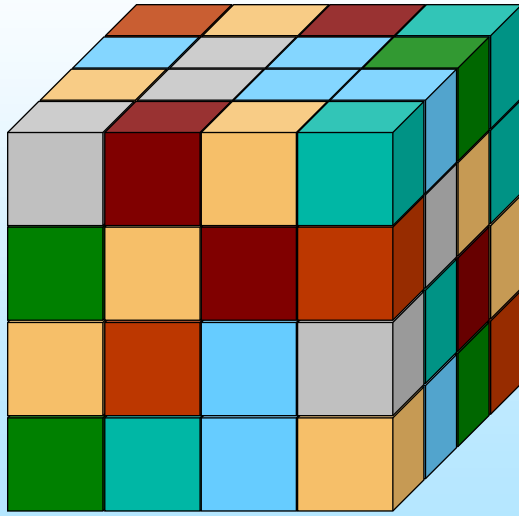


However, as it is impracticable to deal with more than between 7 or 10 market segments, a process has to be found to bring together or cluster all those micro-segments that share similar or approximately similar needs." (see Figure 16)

Figure 16

## Segments in a market
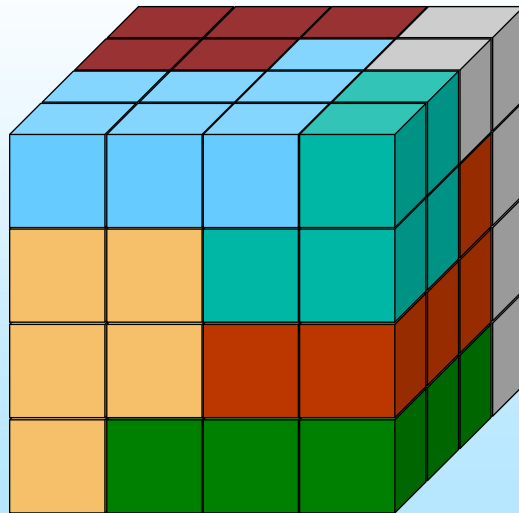


Once the basic work has been done, in describing micro-segments, that is steps 2,3,4 and 5, any good statistical computer program can carryout cluster analysis to arrive at a smaller number of segments. The final step consists of checking whether the resulting segments are big enough to justify separate treatment, are indeed sufficiently different from other segments, whether they have been described sufficiently well to enable the customers in them to be reached by means of the organization's communication methods, and finally, the company has to be prepared to make the necessary changes to meet the needs of the identified segments.

Before summarizing the process of market segmentation, it will by now be clear that market segmentation is fundamental to corporate strategy. It is also clear that, since market segmentation affects every single corporate activity, it should not be just an exercise that takes place within the marketing department, and has to involve other functions. Finally, the most senior levels of management must lead this initiative if their organization is to be truly market or customer need driven.

Table 3 is a summary of what we have discussed so far. It is obvious that there will be very few markets in the world where all customers have the same needs. Also, once market segmentation has been carried out, positioning products and services to meet the different needs of the different segments is comparatively easy. The difficult bit is segmenting markets. The third point is that it is vital to focus on serving the needs of the identified segments, whilst it is dangerous to straddle different segments with the same offer. The photocopier example was only one example of thousands of well-known companies that have suffered from this mistake as markets began to break into segments. The computer industry during the 1980s and 1990s is also replete with examples of this mistake.

Table 3

## Understand market segmentation

- Not all customers in a broadly-defined market have the same needs
- Positioning is easy. Market segmentation is difficult. Positioning problems stem from poor segmentation.
- Select a segment and serve it. Do not straddle segments and sit between them.
  1. Define the market to be segmented and size it (market scope)
  2. Determine how the market works and identify who makes the decisions (market mapping)
  3. Develop a representative sample of decision-makers based on differences they see as key (including what, where, when and how), note who they are (demographics) and size them
  4. Understand their real needs (why they buy, the benefits sought)
  5. Search for groups with similar needs

The process of market segmentation itself consists of 5 steps: One, understand how your market works. This involves defining the market and drawing a market map. Two, list what is bought, including where, when, how, and the different applications of the product or service. Three, list who buys using descriptors such as demographics and psychographics. Four, list why they buy, especially the benefits sought. Five, finally, search for groups with similar needs. These will be the final market segments."

Market structure and market segmentation are the heart and soul of marketing. (see figure 17) Unless an organization spends time on it, driven from the board downwards, it is virtually impossible for it to be market driven, and in any organization that isn't market driven, the marketing function will be ineffective, or at best, will spend its time trying to promote and sell product or services that are inappropriate for the market. We will leave you with this figure

for you to study. It describes in more detail each of the important steps in the market segmentation process.

Figure 17

### The Market Segmentation Process - Summary

**Market mapping**

1. Market definition - 'A customer need that can be satisfied by the products or services seen as alternatives'. It is based around what the customers perceive as distinct activities or needs they have which different customers could be satisfing by using alternative products or services.

2. The distribution and value added chain that exists for the defined market.

3. The decision makers in that market and the amount of product or service they are responsible for in their decision making.

**Who buys**

1. Recording information about the decision makers in terms of who they are - Customer Profiling. Demographics, geographics etc.

2. Testing a current segmentation hypothesis to see if it stacks up - Preliminary Segments.

**What* is bought**

1. Listing the features customers look for in their purchase - what, where, when and how.

2. Focusing in onto those features features customers use to select between the alternative offers available - Key Discriminating Features KDFs.

**Who buys what***

1. Building a customer 'model' of the market - based on either the different combinations of KDFs customers are known to put together, or derived from the random sample in a research project. Can be constructed by Preliminary Segment. Each customer in the model (sample) is called a Micro-segment.

2. Each micro-segment is profiled using information from the data listed in 'Who buys'.

3. Each micro-segment is sized to reflect the value or volume they represent in the market.

**Segment checklist**

1. Is each cluster big enough to justify a distinct marketing strategy?

2. Is the offer required by each cluster sufficiently different?

3. Is it clear which customers appear in each cluster?

   If all 'yes', clusters = segments.

4. Will the company change and adopt a segment focus?

**Forming segments**

1. By attributing a 'score' to all the CPIs for each micro-segment, the similarity between micro-segments can be determined.

2. Micro-segments with similar requirements are brought together to form clusters

3. Clusters are sized by adding the volumes or values represented by each micro-segment.

**Why**

1. As customers only seek out features regarded as key because of the benefit(s) these features are seen to offer them, the benefits delivered by each KDF should be listed. For some customers it is only by combining certain KDFs that they attain the benefit(s) they seek - benefits should also be looked at from this perspective. These benefits are Critical Purchase Influences CPIs.

2. For thoroughness, benefits can be looked at from the perspective of each Preliminary Segment.

3. Once the CPIs for the market have been developed their relative importance to each micro-segment is addressed (by distributing 100 points between the CPIs).

To see the details behind each stage, read Market Segmentation; how to do it; how to profit form it.

Professional market segmentation is hard work, and is time-consuming.

It is worth repeating why market segmentation is so important. Correct market definition is crucial for:

1 share measurement
2 growth measurement
3 the specification of target customers
4 the recognition of relevant competitors
5 the formulation of marketing objectives and strategies

To summarize, the objectives of market segmentation are:

1 to help determine marketing direction through the analysis and understanding of trends and buyer behaviour.
2 to help determine realistic and obtainable marketing and sales objectives.
3 to help improve decision-making by forcing managers to consider in depth the options ahead.

The Future
 The purpose of this final brief section is to point the way to the future of market segmentation
Given that research has shown  ( McDonald 2005 ) that most of the initiatives introduced over the past twenty years ( such as Total Quality Management, Business process re-engineering, Knowledge Management, Balanced Scorecards, Customer Relationship Management and the like ) have "failed ", in the sense of not living up to expectations, there has to be an answer. This answer can be found in a failure on the part of many organisations adopting these initiatives to understand markets and the needs of customers within the segments in these markets as a precursor to developing offers to meet these needs. Without this underpinning, all these excellent initiatives amount to little more than fads adopted as a kind of cure-all to commercial ills and it is not surprising that in such circumstances, they don't work.
Indeed, all these initiatives have worked extremely well in companies that have been truly market-driven.
We are now at a crucial crossroad for the future of marketing. In the UK, for example, few practitioners are professionally qualified. The Chartered Institute of Marketing sits at the very epicentre of marketing education, not just in the UK, but globally, with 300. Study Centres in 132 countries. Qualification through CIM remains the only sensible solution to the malaise that lies at the centre of the marketing discipline, with fewer than one in twenty practitioners being professionally qualified.
Market segmentation lies at the heart of successful marketing practice and is a core discipline within the CIM syllabus.
" Segment or die " will be the mantra as we enter the second decade of the twenty first century.

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