Chapter 3

# Strategic Market Segmentation

Segmenting markets is a foundation for superior performance. Understanding how buyers' needs and wants vary is essential to designing effective marketing strategies. Effective approaches to segmenting markets may be one of the most critical factors in developing and implementing market-driven strategy. The need to improve an organization's understanding of buyers is escalating because of buyers' demands for uniqueness and the growing array of technology available to generate products to satisfy these demands. Companies are responding to the opportunities to provide unique customer value with products ranging from customized phone pagers for business users to self-designed, individualized greeting cards for consumers.

Indeed, McKinsey research underlines the weakness of thinking about markets only in general terms—talking of market trends, growth markets, mass markets, declining markets, and so on—and collecting information that describes only broad trends, where differences within markets are averaged-out. They point to the identification of opportunities from a deeper understanding of markets at a "granular" level. Market fragmentation and increasing granularity characterize a growing number of markets. The compelling logic of market granularity is that effective strategy can emerge only from a much finer understanding of market segments, their needs, and the capabilities required to serve them.[1]

Best Buy provides an interesting illustration of strategic market segmentation. Best Buy is the world's largest electronics retailer with sales revenue of $50 billion. In 2003 Best Buy piloted its "customer-centricity" strategy, radically shifting the company's strategic emphasis from products and technology to customers. The goal was to focus on the most attractive customers based on the important differences between them in their purchasing and preferences in consumer electronics. The customer base has been segmented into several basic lifestyle groups. High-priority target groups are described as:

- **Jill**—the "soccer mom," who is the main shopper for the family, but often avoids electronics stores, well-educated and confident, wants to enrich her children's lives with technology, yet intimidated by technology and jargon
- **Barry**—the wealthy professional man, who demands the latest technology and best service

[1]Patrick Vigerie, Sven Smit and Mehrdad Baghai, *The Granularity of Growth: Making Choices That Drive Enduring Company Performance* (New York: Cyan/Marshall Cavendish), 2007.

- **Buzz**—the young "tech enthusiast," who wants technology and entertainment
- **Ray**—the family man, who wants technology that improves his and his family's life
- **Mr. Storefront**—the small business customer who can use Best Buy's product solutions and services.

Other interesting segments are the **Carries's** (young, single females) and the **Helen and Charlie's** (older couples whose children have left home). Stores have been adapted to serve at least one dominant customer segment shopping at the store—though Jill and Barry stores are a frequent combination of segments in the same store. At the store level, employees are trained to recognize and focus on the needs and preferences of the target segments for that store. Indications are that stores converted to focus on the target segments perform substantially better than other stores.[2]

Best Buy's understanding of the granularity of its consumer markets is further underlined by encouraging local stores to identify and target market niches specific to their areas—eastern European workers from cargo ships or oil tankers docked at Baytown in Houston, Texas, looking for iPods and Apple laptops; Polish-language CDs in Chicago, in an area where 25 percent of residents are Polish speakers; North Carolina retiree clubs; newly returned soldiers in Georgia. Local ingenuity and insight is linked to profiting from market granularity.[3]

In most markets buyers vary in how they use products, the needs and preferences that the products satisfy, and their consumption patterns. These differences create market segments. Market segmentation is the process of identifying and analyzing subgroups of buyers in a product-market with similar response characteristics (e.g., frequency of purchase). Recognizing differences between market segments, and how they change, better and faster than competitors is an increasingly important source of competitive advantage.

In fact, for companies producing consumer products, the concept of a "one-size-fits-all mass market" is increasingly less relevant. Many consumer markets show signs of fragmentation into "microsegments" driven by diverse product preferences and media usage and demanding "right for me" in products purchased.[4] This is why Nike offers more than 300 varieties of sport shoe, not just one.

The most specific form of market segmentation is to consider each buyer as a market segment. This is the basis for "one-to-one marketing."[5] Such fine-tuned segmentation is possible for an expanding array of products due to mass customization techniques (the use of flexible computer-aided manufacturing systems to produce custom output, which combines the low unit costs of mass production processes with the flexibility of individual customization[6]). It offers an exciting new approach to serving the unique needs and wants of individual buyers. Custom-designed products satisfy individual buyer's needs and wants at prices comparable to mass-produced products. The growing adoption of customer relationship management systems that integrate all information about each individual customer into a single location provides unprecedented opportunities to learn about customer needs from their actual behavior. This is discussed in Chapter 4.

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[2]This illustration is based on Ariana Eunjung Cha, "In Retail, Profiling for Profit," *Washington Post,* Wednesday, August 17, 2005, A01; Matthew Boyle, "Best Buy's Giant Gamble," *Fortune,* April 3, 2006.

[3]Jena McGregor, "At Best Buy, Marketing Goes Micro," *BusinessWeek,* May 26, 2008, 52–54.

[4]Anthony Bianco, "The Vanishing Mass Market," *BusinessWeek,* July 12, 2004, 62–68.

[5]Don Peppers and Martha Rogers, *Enterprise One-to-One* (New York: Doubleday), 1997.

[6]Richard B Chase, Robert F. Jacobs, and Nicholas J. Aquilano, *Operations Management for Competitive Advantage,* 11th ed. (New York: McGraw-Hill/Irwin, 2006).

For example, globally the apparel industry is adopting mass-customization technologies to allow clothing to be designed and produced for the individual consumer. Pioneered by Levi Strauss & Co with Personal Pair jeans (later Original Spin), stores as diverse as Brooks Brothers, Harrods in London, Bon Marché in Paris, and other retailers use body scanning to measure dimensions and produce clothes customized for the individual consumer. For Levi's the goal is to reduce the traditional struggle to locate jeans that fit well, into a 10-second shopping experience—when the consumer steps out of the "measure me up" kiosk, personal stylists are available to help choose the best styles. At Harrods, customized apparel by designers like Vivienne Westwood and Nick Holland produced based on body scanning information. Internet-based companies offer mass-customized clothing, including IC3D (Interactive Custom Clothes Company Designs), American Fit, and Beyond Fleece.[7]

We begin the chapter with a discussion of the different purposes that segmentation models can fulfil and the role of market segmentation in marketing strategy, followed by a discussion of the variables used to identify segments. Next, we look at the methods for forming segments followed by a review of high-variety strategies. Finally, we consider the issues and guidelines involved in selecting the segmentation strategy and in its implementation.

## Levels and Types of Market Segmentation

Segmentation is an important tool in strategic marketing, which is linked to choosing market targets and positioning against alternatives to build competitive advantage. Importantly, segmentation may serve several purposes at levels which range from the strategic to the operational. The Best Buy analysis of its customer base and realignment of its stores and employee behaviors around segments illustrates an interesting approach to strategic market segmentation. Many traditional views emphasize segmentation as an operational tool—for example, to aim advertising effectively at different types of customers.

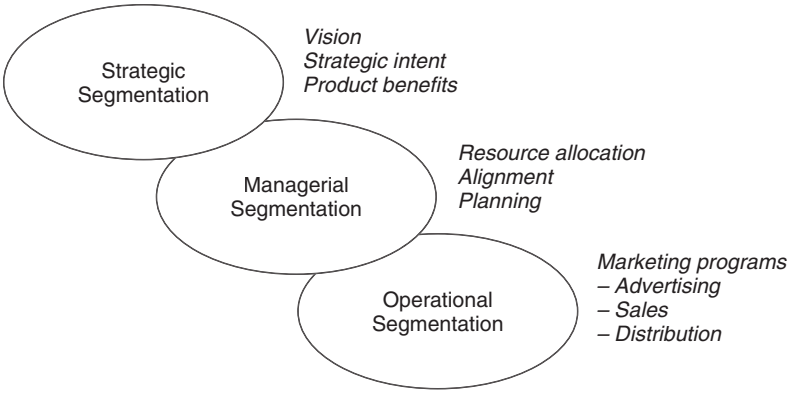
However, segmentation models appropriate to developing advertising programs may be quite different to those used to develop marketing strategy. While advertising-oriented segmentation aims to identify targets that differ in their responses to a given message, strategic segmentation has the goal of identifying market segments that differ in their purchasing power, goals, aspirations and behavior, in ways relevant to identifying new product and value opportunities.[8]

It is useful to examine segmentation as operating at several decision-making levels in the way suggested by see Exhibit 3.1. Strategic segmentation links to the management vision and strategic intent of corporate strategy, and emphasizes product benefits that different types of buyers seek. Managerial segmentation is concerned with allocating resources around segment targets, including them in marketing plans, and aligning organizational processes around them. Operational segmentation issues are concerned with the marketing program changes needed to reach segment targets with advertising and promotions, and with distribution systems. The Best Buy example illustrates these levels of segmentation approach. The strategic issues are concerned with consumer lifestyles and the benefits that different types of consumers seek in choosing and purchasing consumer electronics. The managerial issues are concerned with identifying target segment members, redesigning stores to serve chosen segments, and providing employees with the training and power to

[7]Hadley Freeman, "Nothing In Your Size? Stores Seek to Measure Up," *The Guardian,* September 6, 2006; "Levi's Extends Its 10 Second Fitting Kiosk Market Tour," *TheWiseMarketer.com,* September 6, 2006.

[8]Daniel Yankelovich and David Meer, "Rediscovering Market Segmentation," *Harvard Business Review,* February 2006, 122–131.

**EXHIBIT 3.1**
**Levels of Market Segmentation**




focus on the segment targets. Operational segmentation issues are concerned with delivering relevant messages to targets, and supporting the segmentation strategy at store level.

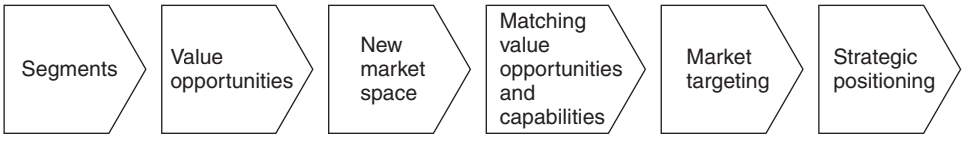
In considering the role of segmentation, the deepest decisions are whether to revise the business model in response to how social forces are changing the lives of different types of customer, how to position a brand, which segments to pursue, and whether to make fundamental changes to the product or to develop and entirely new product. The shallowest decisions are concerned with issues like whether to make small improvements in existing products, how to select targets of a media campaign, or whether to adjust prices.[9]

It is important to effective market-driven strategy that these different aspects of segmentation should be aligned and integrated. The goal of strategic marketing segmentation is to support processes whereby products are designed and developed around the needs of different types of purchaser to offer superior customer value, and then to identify the mechanisms by which that value can be delivered. This requires segmenting markets in ways that reflect how customers actually live their lives and the jobs that they need to get done.[10]

## Market-Driven Strategy and Segmentation

Market segmentation needs to be considered early in the development of market-driven strategy. Segments are identified, customer value opportunities and new market spaces are explored in each segment, organizational capabilities are matched to promising segment opportunities, market target(s) are selected from the segment(s) of interest, and a positioning strategy is developed and implemented for each market target (see Exhibit 3.2). We examine each of these activities to indicate the role of segmentation in the marketing strategy process.

**EXHIBIT 3.2**
**Segmentation in the Market-Driven Strategy Process**




[9]Daniel Yankelovich and David Meer, "Rediscovering Market Segmentation," *Harvard Business Review,* February 2006, 122–131.
[10]Clayton M. Christensen, Scott Cook, and Taddy Hall, "Marketing Malpractice: The Cause and the Cure," *Harvard Business Review,* December 2005, 74–83.

## Market Segmentation, Value Opportunities and New Market Space

Market segmentation is the process of placing the buyers in a product-market into subgroups so that the members of each segment display similar responsiveness to a particular positioning strategy. Buyer similarities are indicated by the amount and frequency of purchase, loyalty to a particular brand, how the product is used, and other measures of responsiveness. So, segmentation is an identification process aimed at finding subgroups of buyers within a total market. The opportunity for segmentation occurs when differences in buyers' demand (response) functions allow market demand to be divided into segments, each with a distinct demand function.[11] For example, auto manufacturer Subaru has established a fiercely loyal body of consumers in its market niche, with a focus on "experience seekers" and particular success in locations that have hills and snow.[12] On the other hand, office products distributor Staples has introduced its "M by Staples" products to tempt the market niche comprising stationery "addicts," with more expensive, better-designed alternatives to standard stationery products.[13]

The term "market niche" is sometimes used to refer to a market segment that represents a relatively small portion of the buyers in the total market. We consider a niche and a segment to be the same.

Segmentation identifies customer groups within a product-market, each containing buyers with similar value requirements concerning specific product/brand attributes. A segment is a possible market target for an organization competing in the market. Segmentation offers a company an opportunity to better match its products and capabilities to buyers' value requirements. Customer satisfaction can be improved by providing a value offering that matches the value proposition considered most important by the buyer in a segment.

Importantly, market analysis may identify segments not recognized or served effectively by competitors. There may be opportunities to tap into new areas of value and create a unique space in the market. For example, while the luxury hotel business is highly competitive and has been hard-hit by economic recession, several companies have been able to develop profitable opportunities. Interestingly, the newest hotel formats are boutique or lifestyle hotels, where sales growth is considerably higher than in the mainstream hotel business. This development is described in the INNOVATION APPLICATION.

While broad competitive comparisons can be made for an entire product-market, more penetrating insights about competitive advantage and market opportunity result from market segment analyses. Examining specific market segments helps to identify how to (1) attain a closer match between buyers' value preferences and the organization's capabilities, and (2) compare the organization's strengths (and weaknesses) to the key competitors in each segment.

## Market Targeting and Strategic Positioning

Market targeting consists of evaluating and selecting one or more segments whose value requirements provide a good match with the organization's capabilities. Companies typically appeal to only a portion of the people or organizations in a product-market, regardless of how many segments are targeted. Management may decide to target one, a few, or several segments to gain the strength and advantage of specialization. Alternatively, while

[11]Peter R. Dickson and James L. Ginter, "Market Segmentation, Product Differentiation, and Marketing Strategy," *Journal of Marketing,* April 1987, 1–10.
[12]Bernard Simon, "On the Trail of Experience-Seekers On and Off the Road," *Financial Times,* July 17, 2009, 12.
[13]Aaron Pressman, "Upwardly Mobile Stationery," *BusinessWeek,* March 17, 2008, 60–61.

## Innovation Application

## *New Life-Style Segments for Luxury Hotels*

Luxury hotels have recognized that different people want different things from upmarket accommodation—the customer staying at a convention hotel has different needs than the senior executive traveling on business or the leisure traveler. Rivals have developed quirkier and more individualistic lifestyle hotel formats to reflect this evolving segmentation in their market, where some travelers find traditional hotels too staid and uniform. These new formats tap into several areas of above-average growth prospects and unmet customer needs.

- Marriott, whose "one-size-fits-all" hotel chain is sometimes called "the McDonalds of lodging" is partnering with Ian Schroder, king of the design hotel, to create the Edition boutique hotels aimed at younger, wealthier, more fashionable travellers, to gain entry to the fastest-growing sector of the market-boutique hotel growth is running at 11 percent a year in the United States, one-third above the industry norm.
- Chicago-based Hyatt Hotels and Resorts has launched its first boutique hotel in the form of the Andaz (an Urdu word meaning "personal style"), with minimalist design concepts.
- InterContinental Hotels has its Indigo boutique hotel format.
- Starwood has won plaudits for its stylish W chain and is expanding its new Aloft concept.
- In addition, Hyatt Hotels and Resorts recognized that the Internet was a surefire way to reach the gay, lesbian, bisexual, and transgender (GLBT) market, and launched its own GLBT website, winning PlanetOut's "Best Hotel Collection" award for its commitment, sensitivity, and appeal to lesbian, gay, bisexual, and transgender travelers.

**Sources:** Deborah L. Vence, "Divide and Conquer," *Marketing News*, July 15, 2007, 15–18. John Arlidge, "Marriott Goes for Boutique Hotels," *Sunday Times*, November 11, 2007, S3, 7. Matthew Goodman, "Hyatt Checks In with Its First Boutique Hotel," *Sunday Times*, November 18, 2007, S3, 10.

a specific segment strategy is not used, the marketing program selected by management is likely to appeal to a particular subgroup of buyers within the market. Segment identification and targeting are obviously preferred. Finding a segment by chance does not give management the opportunity of evaluating different segments in terms of the financial and competitive advantage implications of each segment. When segmentation is employed, it should be by design, and the underlying analyses should lead to the selection of one or more promising segments to target.

Recall the Chapter 1 description of positioning strategy as the combination of the actions management takes to meet the needs and wants of each market target. The strategy consists of product(s) and supporting services, distribution, pricing, and promotion components. Management's choices about how to influence target buyers to favorably position the product in their eyes and minds help in designing the positioning strategy.

The GLOBAL APPLICATION describes the positioning strategy chosen by BMW for the new Mini, as a lifestyle vehicle, and the innovative marketing program choices that fit with buyer characteristics in this niche of the automobile market.

Market segmentation lays the groundwork for market targeting and positioning strategies. The skills and insights used in segmenting a product-market may give a company important competitive advantages by identifying buyer groups that will respond favorably to the firm's marketing efforts. The previous Best Buy example is illustrative. Faulty segmentation reduces the effectiveness of targeting and positioning decisions. For example, when apparel retailer Talbots attempted to attract new, younger consumers to their stores, they risked alienating shoppers who were already loyal fans. The result of trying to entice "thirtysomethings" with cocktail dresses and frilly tank tops was to leave the pearl-wearing

# Global Application *The BMW Mini*

- Notwithstanding depressed car markets in the United States and Europe, BMW's remake of the 1959 classic is one of the most successful model overhauls ever. The Oxford, England, factory is running at full capacity, producing 300,000 vehicles a year. In 2007, the plant produced the millionth Mini. Following an electric powered version and a four-wheel driver, 2011 saw the announcement of the Mini Rocketman, smaller and even closer in design to the 1959 original.


- The new Mini look is a cute snout and bull-dog-like stance, offering an appealing contrast to boxy sports utility vehicles. While based on the original Mini, this is a premium priced vehicle, packed with technology. The car is positioned to be "quintessentially cool"—its biggest selling point is its individualistic appeal.
- Budget for the U.S. launch was only $13 million, so BMW used event-focused "guerrilla tactics," unconventional stunts, and irreverent humor to spark an infectious buzz. One of the first Mini-sightings in the United States was a Mini strapped to the roof of a sports utility vehicle with the sign "What are you doing for fun this weekend?" The Mini also appeared seated in football stadiums like a fan watching the game.
- The cool status of the Mini was cemented in place when it was used in the 2003 remake of the movie *The Italian Job*. The 2006 launch of the Mini-Cooper used an Internet-only campaign in homage to *The Matrix*.
- When the Mini convertible came to the U.S. and European market in 2004, the cars was delivered with the top down and a seal to be broken when the roof was raised for the first time. Buyers were asked to sign a mock contract committing them to keep the roof down as long as they could—to stay true to the Mini convertible's open-minded spirit.
- BMW nurtured Mini mania by keeping supply just short of demand. More than half of buyers custom-order the mini and wait three months for delivery. Prospective Mini purchasers are "net savvy"—the Mini Cooper launch in 2007 was led by an Internet-only teaser produced by a digital ad agency, not conventional TV and cinema advertising.

**Source:** Gail Edmondson and Michael Eidam, "The Mini Just Keeps Getting Mightier," *BusinessWeek*, April 5, 2004, 26. John Reed, "Millionth Mini Marks Milestone for BMW," *Financial Times*, April 16, 2007, 4. John Arlidge, "BMW Creates a Mini Monster," *Sunday Times*, September 26, 2010, S3, 1.

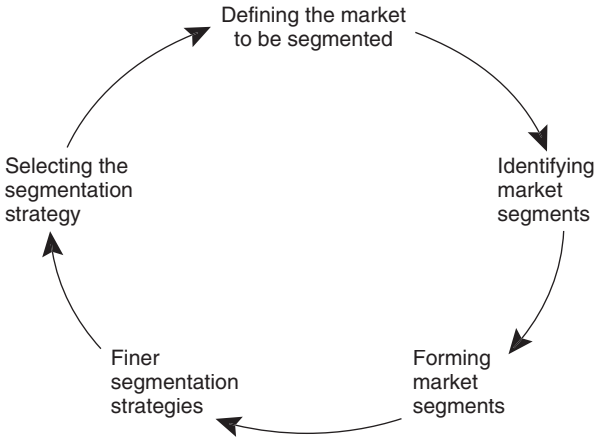
career woman feeling neglected. Talbots has suffered badly from faulty segmentation reflected in sales losses and lower stock price.[14]

## Activities and Decisions in Market Segmentation

The process of segmenting a market involves several interrelated activities and decisions beginning with defining the market to be segmented (see Exhibit 3.3). It is necessary to decide how to segment the market and identifying segments, which involves selecting the

[14]Ashley Lutz, "How Talbots Got the Girl and Lost the Woman," *BusinessWeek,* June 20–25, 2011, 25–26.

**EXHIBIT 3.3**
**Activities and Decisions in Market Segmentation**




variable(s) to use as the basis for identifying segments. For example, frequency of use of a product (e.g., frequent, moderate, and occasional) may be a possible basis for segmentation. Next, the method of forming market segments is decided. This may consist of managers using judgment and experience to divide the market into segments. Alternatively, segments may be formed using statistical analysis. The availability of customer purchase behavior information in CRM systems, for example, provides a growing base for this analysis. Part of forming segments is deciding whether finer (smaller) segments should be used. Finally, strategic analysis is conducted on each segment to assist management in deciding which segment(s) to target.

## Defining the Market to Be Segmented

Market segmentation may occur at any of the product-market levels shown in see Exhibit 3.4. Generic-level segmentation is illustrated by segmenting supermarket buyers based on shopper types (e.g., on the basis of available shopping time). Product-type segmentation is shown by the differences in price, quality, and features of shaving equipment. Product variant–segmentation considers the segments within a category such as electric razors.

An important consideration in defining the market to be segmented is estimating the variation in buyers' needs and requirements at the different product-market levels and identifying the types of buyers included in the market. The boutique hotel format discussed in the earlier INNOVATION APPLICATION illustrates a strategy focused on a specific segment. Nonetheless, in contemporary markets, boundaries and definitions can

**EXHIBIT 3.4**
**Market Segmentation in the Health and Beauty Supplies Market**

| Level of Competition | Product Definition | Illustrative Competitors | Need/Want Satisfied |
|---|---|---|---|
| Generic | Health and beauty aids | Consumer products companies | Enhancement of health and beauty |
| Product type | Shaving equipment | Gillette, Remington, Bic | Shaving |
| Product variant | Electric razors | Braun, Norelco, Remington, Panasonic | Electric shaving |

change rapidly, underlining the strategic importance of market definition and selection, and the need for frequent re-evaluation.

# Identifying Market Segments

After the market to be segmented is defined, one or more variables are selected to identify segments. For example, the U.S. Automobile Association (USAA) segments by type of employment. Although unknown to many people, USAA has built a successful business serving the financial services needs of U.S. military personnel located throughout the world. USAA has close relationships with its 6.8 million members using powerful information technology. The USAA service representative has immediate access to the client's consolidated file, and the one-to-one service encounter is highly personalized, and USAA achieves a 98 percent retention rate in its market chosen segment.[15] In 2007, USAA was "#1 Customer Service Champ" in Bloomberg BusinessWeek's survey, and retained number 1 or 2 position for four years running.[16] In 2011, USAA was recognized by J.D. Powers for a decade of outstanding customer satisfaction.[17]

First, we discuss segmentation variables, followed by a review of the variables that are used in segmentation analyses.

## Segmentation Variables

One or more variables (e.g., frequency of use) may be used to divide the product-market into segments. *Demographic* and *psychographic* (lifestyle and personality) characteristics of buyers are of interest, since this information is available from the U.S. Census reports and many other sources including electronic databases. The *use situation* variables consider how the buyer uses the product, such as purchasing a meal away from home for the purpose of entertainment. Variables measuring buyers' *needs* and *preferences* include attitudes, brand awareness, and brand preference. *Purchase-behavior* variables describe brand-use and consumption (e.g., size and frequency of purchase). We examine these variables to highlight their uses, features, and other considerations important in segmenting markets.

## Characteristics of People and Organizations

### *Consumer Markets*

The characteristics of people fall into two major categories: (1) geographic and demographic and (2) psychographic (lifestyle and personality). Demographics are often more useful to describe consumer segments after they have been formed rather than to identify them. Nonetheless, these variables are popular because available data often relate demographics to the other segmentation variables. Geographic location may be useful for segmenting product-markets. For example, more than 20 years since the fall of the Berlin wall, underlying values expressed in brand preferences still differ between eastern German consumers and western Germans. Detergent Persil was a top seller in the west but not the east—Persil was seen in the east as an elite product for the rich people portrayed in the TV advertising. The appeal of the brand in the east only increased in response to a more

[15]Leonard L. Berry, "Relationship Marketing of Services—Growing Interest, Emerging Perspectives," *Journal of the Academy of Marketing Science,* Fall 1995, 238–240.

[16]Jena McGregor, "Customer Service Champs," *BusinessWeek,* February 18, 2010, www.businessweek.com, accessed July 12, 2011.

[17]www.usaa.com/…/about_usaa_corporate_overview_awards_and_rankings, accessed June 24 2011.

emotional and ironic appeal. Other western brands have encountered similar barriers in the unified German state.[18]

Demographic variables describe buyers according to their age, income, education, occupation, and many other characteristics. Demographic information helps to describe groups of buyers such as heavy users of a product or brand. Demographics used in combination with buyer behavior information are useful in segmenting markets, selecting distribution channels, designing promotion strategies, and other decisions on marketing strategy.

Lifestyle variables indicate what people do (activities), their interests, their opinions, and their buying behavior. Lifestyle characteristics extend beyond demographics and offer a more penetrating description of the consumer.[19] Profiles can be developed using lifestyle characteristics. This information is used to segment markets, help position products, and guide the design of advertising messages.

For example, consumer goods companies in many personal care and beauty product areas are looking for sales growth with male purchasers, rather than females. The male shopper is conventionally not well understood by companies in these product fields. Lifestyle and product choice differences between different types of males are shown in the STRATEGY APPLICATION. While crude, this model provides an initial basis for examining product development opportunities for different segments of the male personal care product market.

### *Organizational Markets*

Several characteristics help in segmenting business markets. The type of industry (sometimes called a vertical market) is related to purchase behavior for certain types of products. For example, automobile producers purchase steel, paint, and other raw materials. Since automobile firms' needs may vary from companies in other industries, this form of segmentation enables suppliers to specialize their efforts and satisfy customer needs. Other variables for segmenting organizational markets include size of the company, the stage of industry development, and the stage of the value-added system (e.g., producer, distribution, retailer). Organizational segmentation is aided by first examining (1) the extent of market concentration, and (2) the degree of product customization.[20] Concentration considers the number of customers and their relative buying power. Product customization determines the extent to which the supplier must tailor the product to each organizational buyer. If one or both of these factors indicate quite a bit of diversity, segmentation opportunities may exist.

For example, Boeing caters to the specific needs of each air carrier purchasing commercial aircraft, adapting designs to meet customer priorities. Nonetheless, the costs of customization are high and Boeing has had to evaluate the value/cost relationships of its attempts to satisfy the needs of single airline segments.

## Product Use Situation Segmentation

Markets can be segmented based on how the product is used. As an illustration, Nikon, the Japanese camera and precision instruments company, offers a line of high-performance sunglasses designed for activities and light conditions when skiing, snowboarding, skating, and driving. Nikon competes in the premium portion of the market with prices somewhat higher than Ray-Ban, the market leader. Timex uses a similar basis of segmentation for its watches.

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[18]Hugh Williamson, "Advertisers Try to Bridge Germany's Consumer Divide," *Financial Times,* July 27, 2007, 12.
[19]Henry Assael, *Consumer Behavior and Marketing Action,* 2nd ed. (Boston: PWS-Kent Publishing, 1984), 225.
[20]Jay L. Laughlin and Charles R. Taylor, "An Approach to Industrial Market Segmentation," *Industrial Marketing Management,* 20 1991, 127–136.

## Strategy Application *The Male Shopper*

Consumer products companies in fields like personal care and cosmetics are focusing more attention on the male consumer. They are having to re-think the characteristics of the male purchaser. Male shopper stereotypes or segments include:

**The Metrosexual**

- The affluent, urban sophisticate, who adds deeper meaning, quality, and beauty to consumption. Thinks of loafers as objets d'art.
- P&G, Beiersdorf, and Polo Ralph Lauren do good business with the metro.

**The Maturiteen**

- More savvy, responsible, mature, and pragmatic than previous cohorts, with poise attributed to baby boomer parents who treat kids as equals.
- A technology master, adept at online research, often acting as an inhouse shopping consultant. Never knew a time without the Web, and its interactivity has nurtured in them a radical view of brands—they own them.
- Adidas, Sony, and Unilever are skillful at playing along with them.

**The Modern Man**

- Neither retro nor metro, he's something in the middle. A sophisticated consumer in his 20s and 30s—a bigger shopper than his dad, but still a sports fan
- Comfortable with women but doesn't like shopping with them. Moisturizer and hair gel are perfectly ordinary to him.
- Philips Norelco used locker-room humor to get the modern man comfortable with the below-the-neck shaver, Bodygroom.

**The Dad**

- Largely ignored, but in their peak earning years
- Smart companies like Dyson and Patek Philippe are reaching out to them.

**The Retrosexual**

- If the metrosexual champions the female ethos with a "go Girl," the retrosexual is screaming "Stop!" Has lived through the same cultural turmoil and consumerism, but rejects feminism and happily wallows in traditional male behavior. Nostalgic for the good old days before moisturizers for men.
- Burger King and P&G's Old Spice have this dude nailed.

**Source:** Nanette Byrnes, "Secrets of the Male Shopper," *BusinessWeek*, September 4, 2006, 45–54.

Needs and preferences vary according to different use situations. Consider, for example, segmenting the market for prescription drugs. Astra/Merck identifies the following segments based on the type of physician/patient drug use situation:

- **Health care as a business**—customers such as managed care administrators who consider economic factors of drug use foremost.
- **Traditional**—physicians with standard patient needs centered around the treatment of disease.
- **Cost sensitive**—physicians for whom cost is paramount, such as those with a sizable number of indigent patients.
- **Medical thought leaders**—people on the leading edge, often at teaching hospitals, who champion the newest therapies.[21]

[21]Daniel S. Levine, "Justice Served," *Sales & Marketing Management,* May, 1995, 53–61.

A sales representative provides the medical thought leader with cutting-edge clinical studies, whereas the cost-sensitive doctor is provided information related to costs of treatments.

Mass customization offers a promising means of responding to different use situations at competitive prices. Recall the earlier clothing industry examples.

## Buyers' Needs and Preferences

Needs and preferences that are specific to products and brands can be used as segmentation bases and segment descriptors. Examples include brand loyalty status, benefits sought, and proneness to make a deal. Buyers may be attracted to different brands because of the benefits they offer. For example, the "fairtrade" branding of products as diverse as coffee and clothing, with goals of benefiting producers in developing countries, has shown remarkable growth. The segment consists of consumers who are prepared to pay a higher price for staple products, if their actions benefit people in poorer countries. This is an example of "ethical branding" aimed at a new and growing segment of ethically-motivated consumers.[22]

### *Consumer Needs*

Needs motivate people to act. Understanding how buyers satisfy their needs provides guidelines for marketing actions. Consumers attempt to match their needs with the products that satisfy their needs. People have a variety of needs, including basic physiological needs (food, rest, and sex); the need for safety; the need for relationships with other people (friendship); and personal satisfaction needs.[23] Understanding the nature and intensity of these needs is important in (1) determining how well a particular brand may satisfy the need, and/or (2) indicating what change(s) in the brand may be necessary to provide a better solution to the buyer's needs.

### *Attitudes*

Buyer's attitudes toward brands are important because experience and research findings indicate that attitudes influence behavior. Attitudes are enduring systems of favorable or unfavorable evaluations about brands.[24] They reflect the buyer's overall liking or preference for a brand. Attitudes may develop from personal experience, interactions with other buyers, or by marketing efforts, such as advertising and personal selling.

Attitude information is useful in marketing strategy development. A strategy may be designed either to respond to established attitudes or, instead, to attempt to change an attitude. In a given situation, relevant attitudes should be identified and measured to indicate how brands compare. If important attitude influences on buyer behavior are identified and a firm's brand is measured against these attitudes, management may be able to improve the brand's position by using this information. Attitudes are often difficult to change, but firms may be able to do so if buyers' perceptions about the brand are incorrect. For example, if the trade-in value of an automobile is important to buyers in a targeted segment and a company learns through market research that its brand (which actually has a high trade-in value) is perceived as having a low trade-in value, advertising can communicate this information to buyers.

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[22]Meg Carter, "Big Business Pitches Itself on Fair Trade Territory," *Financial Times,* October 25, 2005, 13.
[23]A. H. Maslow, "Theory of Human Motivation," *Psychology Review,* July 1943, 43–45.
[24]Assael, *Consumer Behavior and Marketing Action,* 650.

**EXHIBIT 3.5**
**Television Viewers Watch Fewer Ads**

Source: Survey of the 15 largest U.S. television markets in 2003 by CNW Marketing Research Inc. reported in Anthony Bianco, "The Vanishing Mass Market," *BusinessWeek,* July 12, 2004, 65.

| | Ads Actively Ignored on Television | Ads Skipped Using Personal Video Recorder |
|---|---|---|
| Beer | 4.8% | 31.9% |
| Movie trailers | 11.6 | 44.1 |
| Soft drinks | 21.6 | 82.7 |
| Drug | 32.3 | 45.6 |
| Specialty clothing | 33.4 | 62.4 |
| Home products | 41.6 | 90.3 |
| Fast food | 45.1 | 95.7 |
| Cars (national) | 52.8 | 68.8 |
| Pet-related | 55.5 | 81.5 |
| Credit cards | 62.7 | 94.2 |
| Mortgage financing | 74.1 | 94.7 |
| Upcoming program | 75.3 | 94.4 |
| Unweighted average | 43.1 | 71.6 |

### *Perceptions*

Perception is defined as "the process by which an individual selects, organizes, and interprets information inputs to create a meaningful picture of the world."[25] Perceptions are how buyers select, organize, and interpret marketing stimuli, such as advertising, personal selling, price, and the product. Perceptions form attitudes. Buyers are selective in the information they process. As an illustration of selective perception, some advertising messages may not be received by viewers because of the large number of messages vying for their attention. For example, see Exhibit 3.5 lists products where substantial proportions of TV advertisements are actively ignored or skipped using a personal video recorder. Negative attitudes and perception may be a major barrier to communicating with consumers. Or, more simply, for example, a salesperson's conversation may be misunderstood or not understood because the buyer is trying to decide if the purchase is necessary while the salesperson is talking.

People often perceive things differently. Business executives are interested in how their products, salespeople, stores, and companies are perceived. Perception is important strategically in helping management to evaluate the current positioning strategy and in making changes in this positioning strategy. Perception mapping is a useful research technique for showing how brands are perceived by buyers according to various criteria. We discuss how preference mapping is used to form segments later in the chapter.

## Purchase Behavior

Consumption variables such as the size and frequency of a purchase are useful in segmenting consumer and business markets. Marketers of industrial products often classify customers and prospects into categories on the basis of the volume of the purchase. For example, a specialty chemical producer concentrates its marketing efforts on chemical users that purchase at least $100,000 of chemicals each year. The firm further segments the market on the basis of how the customer uses the chemical.

The development of CRM systems offers fast access to records of actual customer purchase behavior and characteristics. CRM and loyalty programs are generating insights into

[25]Bernard Berelson and Gary A. Steiner, *Human Behavior: An Inventory of Scientific Findings* (New York: Harcourt Brace Jovanovich, 1964), 88.

customer behavior and segment differences, and providing the ability to respond more precisely to the needs of customers in different segments. We discuss the impact of CRM on analyzing customer characteristics in Chapter 4.

Interestingly, level of product use may not necessarily identify the best value opportunities. While casino companies call their best customers (gamblers) "whales" (and give them free hotel rooms and special tables with high limits), yet in the cell phone business the top 1 percent of wireless data customers who provide 30 percent of the traffic are stigmatized as "gluttons" or "bandwidth hogs" (and operators want to penalize them with higher prices).[26]

Since buying decisions vary in importance and complexity, it is useful to classify them to better understand their characteristics, the products to which they apply, and the marketing strategy implications of each type of purchase behavior. Buyer decisions can be classified according to the extent to which the buyer is involved in the decision.[27] A high-involvement decision may be an expensive purchase, have important personal consequences, and impact the consumer's ego and social needs. The decision situation may consist of extended problem solving (high involvement), limited problem solving, or routine problem solving (low involvement). The characteristics of these situations are illustrated in see Exhibit 3.6.

These categories are very broad since the range of involvement covers various buying situations. Even so, the classifications provide a useful way to compare and contrast buying situations. Also, involvement may vary from individual to individual. For example, a high-involvement purchase for one person may not be such for another person, since perceptions of expense, personal consequences, and social impact may vary across individuals. See Exhibit 3.7 summarizes the various segmentation variables and shows examples of segmentation bases and descriptors for consumer and organizational markets. As we examine the methods used to form segments, the role of these variables in segment determination and analysis is illustrated.

For example, a brand perspective is sometimes represented by a single "golden question" posed to consumers. One manufacturer of an expensive, upmarket, premium cat food in Europe identified prospective members of the high-maintenance cat-pampering segment with the question "Do you buy your cat a birthday present?" (a positive response was a good indicator of a consumer likely to pay over the odds for a premium cat food).

**EXHIBIT 3.6**
**Consumer Involvement in Purchase Decisions**

Source: Eric N. Berkowitz, Roger A. Kerin, Steven W. Hartley, and William Rudelius, *Marketing,* 5th ed. (Chicago: Richard D. Irwin, 1997), 156. Copyright © The McGraw-Hill Companies. Used with permission.

| | Consumer Involvement | | |
|---|---|---|---|
| | High | | Low |
| **Characteristics of Purchase Decision Process** | **Extended Problem Solving** | **Limited Problem Solving** | **Routine Problem Solving** |
| Number of brands examined | Many | Several | One |
| Number of sellers considered | Many | Several | Few |
| Number of product attributes evaluated | Many | Moderate | One |
| Number of external information sources used | Many | Few | None |
| Time spent searching | Considerable | Little | Minimal |

[26]Brendan Greeley, "Who Are You Calling a Data Hog?" *Bloomberg BusinessWeek,* February 14–20, 2011, 31–32.
[27]Eric N. Berkowitz, Steven W. Hartley, William Rudelius, and Roger A. Kerin, *Marketing,* 7th ed. (Burr Ridge, IL: McGraw-Hill/Irwin), 2003.

**EXHIBIT 3.7**
**Illustrative Segmentation Variables**

Source: Eric N. Berkowitz, Steven W. Hartley, William Rudelius, and Roger A. Kerin, *Marketing,* 7th ed. (Burr Ridge, IL: McGraw-Hill/Irwin, 2003).

| | Consumer Markets | Industrial/Organizational Markets |
|---|---|---|
| Characteristics of people/ organizations | Age, gender, race<br>Income<br>Family size<br>Lifecycle stage<br>Geographic location<br>Lifestyle | Type of industry<br>Size<br>Geographic location<br>Corporate culture<br>Stage of development<br>Producer/intermediary |
| Use situation | Occasion<br>Importance of purchase<br>Prior experience with product<br>User status | Application<br>Purchasing procedure<br>New task, modified rebuy, straight rebuy |
| Buyers' needs/ preferences | Brand loyalty status<br>Brand preference<br>Benefits sought<br>Quality<br>Proneness to make a deal | Performance requirements<br>Brand preferences<br>Desired features<br>Service requirements |
| Purchase behavior | Size of purchase<br>Frequency of purchase | Volume<br>Frequency of purchase |

The question was later refined to "Do you spend more on your cat's birthday or Christmas present?" (any thought given to the issue suggested a member of the target segment).

# Forming Market Segments

Turning round the performance of Miller Brewing's business was in part based on developing new strategic segment targets for Miller's beer brands. Targets for some of the biggest brands are:

- **Miller Genuine Draft**—aiming at "mainstream sophisticates," males aged 25–35 attracted by the tag line "Beer. Grown Up."
- **Milwaukee's Best Light**—targeting "hardworking men" with a beer to be picked up after a long day at work, sponsors the World Series of Poker on ESPN to get the attention of these poker-playing consumers
- **Pilsner Urquell**—for "beer aficionados," or more discerning drinkers. Select salespeople—"beer merchants"—educate bar staff and retailers on the special character of the Czech beer, the original golden pilsner
- **Miller Icehouse**—for "drinking buddies," hanging out, playing Xbox, or getting ready to go out, targeting the modern young male.[28]

The requirements for segmentation are discussed first, and then the methods of segment formation are described and illustrated.

## Requirements for Segmentation

An important question is deciding if it is worthwhile to segment a product-market. For example, for many years Gillette successfully adopted a "one product for all" strategy in the razor market. While in many instances segmentation is a sound strategy, its feasibility

[28]Adrienne Carter, "It's Norman Time," *BusinessWeek,* May 29, 2006, 64–68.

## Internet Application

## *Reaching Market Segments on the Web*

The attractiveness of market segments is influenced by the ability to reach targets with marketing communications. The Internet is rapidly changing the ability to reach both narrow and broad target segments.

J.K. Rowling, author of the books about the boy wizard Harry Potter, announced in 2011 that the Potter books would be available for the first time as e-books, but through an exclusive interactive website offering users access to her "world of wizardry"—on a site named Pottermore—and excluding online stores run by Amazon and Apple.

Potter fans can join one of the Hogwarts wizardry school's houses and travel virtually though the first Harry Potter book, accessing new material from the author, giving fans much-desired insider information into the riddles in the book.

The Potter books have broken publishing records, with sales of 450 million copies worldwide, and adaptations have become a highly bankable movie franchise for Time Warner. The goal of Pottermore is to generate new sales and readership for the mature book properties.

The Pottermore site is a mixture of social networking, gaming, and online literary content, which is free to use, apart from the downloading of e-books. The site has a monopoly over Harry Potter audiobooks and e-books, and Rowling retains control over pricing.

The website provides Rowling with direct access to her young fan base as well as control over the Potter material that reaches them.

**Sources:** Paul Sonne and Jeffrey A. Trachtenberg, "Rowling Conjures E-Books," *Wall Street Journal*, June 24–26, 2011, 19, 23. Helen Warrell and Andrew Edgecliffe-Johnson, "J.K. Rowling to Work Potter Magic Online," *Financial Times*, June 24, 2011, 1. Andrew Edgecliffe-Johnson and Helen Warrell, "Rowling Casts Spell on Digital Publishing," *Financial Times*, June 24, 2011, 3.

and value need to be evaluated. Nonetheless, the growing fragmentation of mature mass-markets into segments with different needs and responsiveness to marketing actions may mandate an effective segmentation strategy. Correspondingly, the growth of narrowcast media—cable television and radio; specialized magazines; cell-phone and personal digital assistant screens; and the Internet—has made major changes to the costs of reaching market segments. Segment targets that could not traditionally be reached with communications and product variants to match their needs at reasonable costs to the seller may now be accessible targets.[29] Indeed, vast databases of people's online behavior are continuously created through tracking technology and cross—referenced with personal data to provide a foundation for predicting interests and future behavior, as well as targeting them very precisely with direct communications and new products.[30]

For example, the INTERNET APPLICATION illustrates how author J.K. Rowling is using the Web to directly access her Harry Potter readership (market segment) and importantly to reach them more precisely with targeted communications, which she controls.

It is important to decide if it is worthwhile to segment a product market. Five criteria are useful for evaluating a potential segmentation strategy.

### *Response Differences*

Determining differences in the responsiveness of the buyers in the product-market to positioning strategies is a key segment identification requirement. Suppose the customers in a product-market are placed into four groups, each a potential segment, using a variable such

[29]Anthony Bianco, "The Vanishing Mass Market," *BusinessWeek,* July 12, 2004, 62–68.

[30]Emily Steel and Julia Angwin, "On the Web's Cutting Edge, Anonymity is in Name Only," *Wall Street Journal,* August 5, 2010, 14–15.

as income (affluent, high, medium, and low). If each group responds (e.g., amount of purchase) in the same way as all other groups to a marketing mix strategy, then the four groups are not market segments. If segments actually exist in this illustration, there must be differences in the responsiveness of the groups to marketing actions, such as pricing, product features, and promotion. The presence of real segments requires actual response differences. Simply finding differences in buyers' characteristics such as income is not enough.

For example, income is useful in finding response differences in emerging markets. Average incomes in the "BRIC" countries are low. In gross domestic product per capita in 2010 the U.S. statistic was $47,200, while in the BRIC countries income was Brazil ($10,800), Russia ($15,700), India ($3,500), and China ($7,600).[31] Nonetheless, emerging market incomes are growing far faster than in the developed countries. In addition, income concentration is typically much higher—in spite of low average incomes, BRIC country billionaires outnumber those in Europe. Sheer population numbers make these markets attractive prospects for food companies like McDonalds and retailers like Tesco and Wal-Mart. However, simultaneously, the rise of an affluent middle class provides an attractive target for luxury goods brands like Mercedes-Benz, Cartier, and Christian Dior. Fast economic growth and globalization place high priority on understanding emerging market income level and dispersion.[32]

### *Identifiable Segments*

It must be possible to identify the customer groups that exhibit response differences, and sometimes finding the correct groups may be difficult. For example, even though variations in the amount of purchase by customers occur in a market, it may not be possible to identify which people correspond to the different response groups in the market. While it is usually feasible to find descriptive differences among the buyers in a product-market, these variations must be matched to response differences. The impact of the Internet is important to identifying segments.

### *Actionable Segments*

A business must be able to aim a marketing program strategy at each segment selected as a market target. Ideally, marketing efforts should focus on the segment of interest and not be wasted on non-segment buyers. Cable television, magazine, and radio media are able to provide coverage of narrowly defined market segments. The Internet offers great potential for direct marketing channels to reach specialized segments. Similarly, databases offer very focused access to buyers.

### *Cost/Benefits of Segmentation*

Segmentation must be financially attractive in terms of revenues generated and costs incurred. It is important to evaluate the benefits of segmentation. While segmentation may cost more in terms of research and added marketing expenses, it should also generate more sales and higher margins. The objective is to use a segmentation approach that offers a favorable revenue and cost combination. Interestingly, Bain & Co research suggests that in their studies over a 5-year period, companies that successfully tailor product and service offerings to desirable customer segments show annual profit growth of around 15 percent—compared to only 5 percent annual growth in other companies in their sectors.[33]

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[31]www.cia.gov/library/publications/the-world-factbook, accessed July 12, 2011.

[32]Neil Buckley, "From Shock Therapy to Retail Therapy: Russia's Middle Class Starts Spending," *Financial Times,* October 31, 2006, 17. Jason Bush, "Russia: Shoppers Gone Wild," *BusinessWeek,* February 20, 2006, 46–47.

[33]Rob Markey, John Ott, and Gerard du Toit, "Winning New Customers Using Loyalty-Based Segmentation," *Strategy and Leadership,* 35(3), 2007, 32–37.

### *Stability over Time*

Finally, the segments must show adequate stability over time so that the firm's marketing efforts will have enough time to produce favorable results. If buyers' needs change too fast, a group with similar response patterns at one point may display quite different patterns several months later. The time period may be too short to justify using a segmentation strategy. However, this question is also one where the impact of narrowcast media and advanced production technology may drastically reduce the time over which a segment targets needs to be stable for it to be an attractive target.

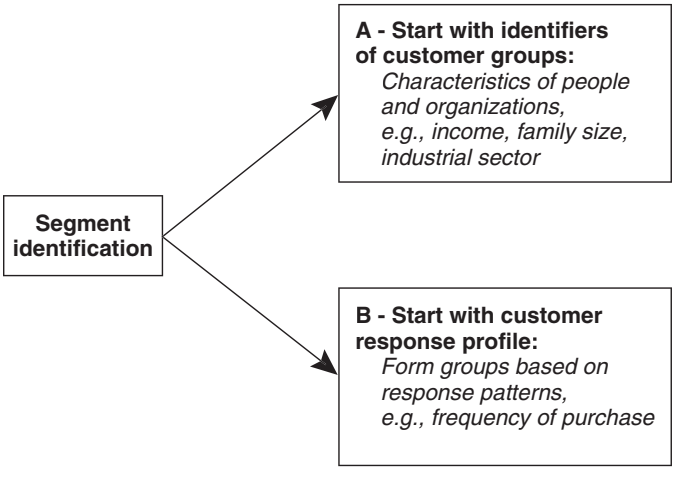
### *Product Differentiation and Market Segmentation*

The distinction between product differentiation and market segmentation is not always clear. *Product differentiation* occurs when a product offering is perceived by the buyer as different from the competition on any physical or nonphysical product characteristic, including price.[34] Using a product differentiation strategy, a firm may target an entire market or one (or more) segments. Competing firms may differentiate their product offerings in trying to gain competitive advantage with the same group of targeted buyers. Market targeting using a differentiation strategy is considered further in Chapter 6.

## Approaches to Segment Identification

Segments are formed by (A) grouping customers using descriptive characteristics and then comparing response differences across the groups or (B) forming groups based on response differences (e.g., frequency of purchase) and determining if the groups can be identified based on differences in their characteristics. see Exhibit 3.8 illustrates the two approaches. Approach A uses a characteristic such as income or family size believed to be related to buyer response. After forming the groups, they are examined to see if response varies across groups. Approach B places buyers with similar response patterns into groups and then develops buyer profiles using buyer characteristics. We describe each approach to show how it is used to identify segments.

**EXHIBIT 3.8**
**Approaches to Segment Identification**




[34]Peter R. Dickson and James L. Ginter, "Market Segmentation, Product Differentiation, and Marketing Strategy," *Journal of Marketing,* April 1987, 1–10.

## Customer Group Identification

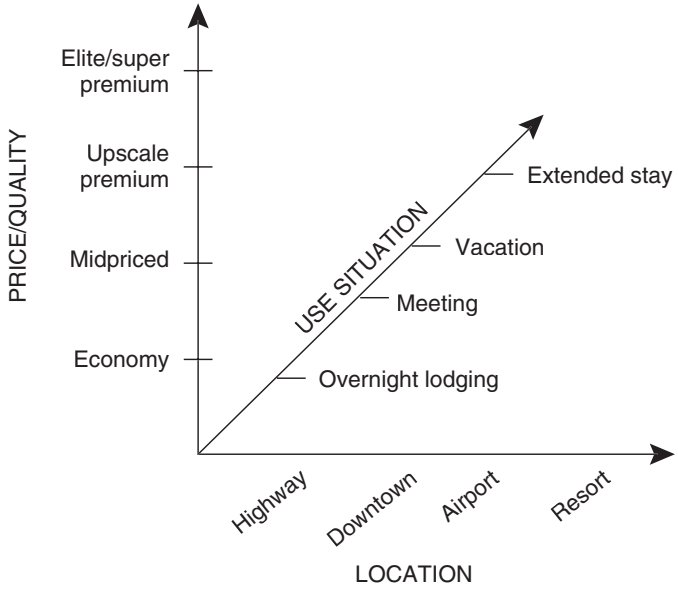
After the product-market of interest is defined, promising segments may be identified, using management judgment in combination with analysis of available information and/or marketing research studies. Consider, for example, hotel lodging services. See Exhibit 3.9 illustrates ways to segment the hotel lodging product-market. An additional breakdown can be made according to business and leisure travelers. These categories may be further refined by individual customer and group customer segments. Groups may include conventions, corporate meetings, and tour groups. Several possible segments can be distinguished. Consider, for example, Marriott's Courtyard hotel chain. These hotels fall into the midpriced category and are targeted primarily to frequent business travelers who fly to destinations, are in the 40-plus age range, and have relatively high incomes.

When using the customer group identification approach, it is necessary to select one or more of the characteristics of people or organizations as the basis of segmentation. Using these variables, segments are formed by (1) management judgment and experience or (2) supporting statistical analyses. The objective is to find differences in responsiveness among the customer groups. We look at some of the customer-grouping methods to show how segments are formed.

### *Management Insight and Available Information*

Management's knowledge of customer needs is often a useful guide to segmentation. For example, both experience and analysis of published information are often helpful in segmenting business markets. Business segment variables include type of industry, size of purchase, and product application. Company records often contain information for analyzing the existing customer base. This is a particularly important contribution of the customer relationship management technology discussed in Chapter 4. Published data such as industry mailing lists can be used to identify potential market segments. These groups are then analyzed to determine if they display different levels of response. Effec-

**EXHIBIT 3.9**
**Product-Market Segmentation Dimensions for Hotel Lodging Services**



## Strategy Application

## *Strategic Flaw of Neglecting Wal-Mart's Core Customer*

A new Wal-Mart CEO was appointed in February of 2009. He moved aggressively to appeal to higher income shoppers attracted by low prices during the 2009–2010 recession. A core objective was to move Wal-Mart upscale.

By 2011, the retailer had experienced two years of declining domestic same-store sales. Walmart neglected its core customers (households earning less than $70,000 a year), in seeking to appeal to higher income customers. Management raised prices on some offerings and offered special promotions on others.

Management recognized its error in early 2011 and altered its targeting strategy and offerings. The new CEO left the company in 2009. The focus was shifted to the core customer segment. The challenge is appealing to the U.S. core customer. Wal-Mart was performing well at Sam's Club and its booming international operation.

**Sources:** Miguel Bostillo, "With Sales Flabby, Wal-mart Turns to It's Core," *Wall Street Journal,* March 21, 2011, B1, B8. Miguel Bostillo, "Wal-Mart Tries to Recapture Mr. Sam's Winning Formula," *Wall Street Journal,* February 22, 2011, A1, A12. Matthew Boyle, "Wal-Mart's Magic Moment," *Bloomberg BusinessWeek*, June 15, 2009, 51–53.

tive segmentation may sometimes be achieved through insight and creativity, but it is important to avoid stereotyped thinking based on industry norms. A distinctive segmentation strategy which does not mirror those of competitors may be an important source of advantage.

Segmenting using management judgment and experience underpins the success of Coach in serving both fashion-conscious consumers and factory outlet customers. The luxury positioning of the Coach brand places it on a par with Gucci, Versace, and Dior, although Coach prices are much lower. Flagship Coach stores are located on Beverley Hills' Rodeo Drive and New York's Madison Avenue. Nonetheless, the fastest-growing part of Coach's business is the factory outlets where the previous season's products are sold at discounted prices. Although an unconventional approach to segmentation in the luxury goods market, Coach carefully manages its brand position with upscale shoppers, but also builds sales with older, bargain-hunters in factory outlets.[35]

Nonetheless, management judgment may be flawed with serious consequences for performance. Wal-Mart's U.S. performance with its core customer segment is illustrative and is discussed in the STRATEGY APPLICATION.

### *Cross Classification Analyses*

Another method of forming segments is to identify customer groups using descriptive characteristics and compare response rates (e.g., sales) by placing the information in a table. Customer groups form the rows and response categories from the columns. Review of industry publications and other published information may identify ways to break up a product-market into segments. Standardized information services such as Information Resources Inc. collect and publish consumer panel data on a regular basis. These data provide a wide range of consumer characteristics, advertising media usage, and other information, which are analyzed by product and brand sales and market share. The data are

[35]Diane Brady, "Coach's Split Personality," *BusinessWeek,* November 7, 2005, 36.

obtained from a large sample of households throughout the United States. Similar statistical data are available in many overseas countries.

Information is available for use in forming population subgroups within product-markets. The analyst can use many sources, as well as management's insights and hunches regarding the market. The essential concern is whether a segmentation scheme identifies customer groups that display different product and brand responsiveness. The more evidence of meaningful differences, the better chance that useful segments exist. Cross-classification has some real advantages in terms of cost and ease of use. There may be a strong basis for choosing a segmenting scheme that uses this approach. This occurs more often in business and organizational markets, where management has a good knowledge of user needs, because there are fewer users than there are in consumer product-markets. Alternatively, this approach may be a first step leading to a more comprehensive type of analysis.

### *Data Mining for Segmentation*

The availability of computerized databases offers a wide range of segmentation analysis capabilities. This type of analysis is particularly useful in consumer market segmentation. Databases are organized by geography and buyers' descriptive characteristics. Databases can be used to identify customer groups, design effective marketing programs, and improve the effectiveness of existing programs. The number of available databases is rapidly expanding, the costs are declining, and the information systems are becoming user-friendly. Several marketing research and direct mail firms offer database services. Further discussion on data mining is provided in Chapter 4.

By identifying customer groups using descriptive characteristics and comparing them to a measure of customer responsiveness to a marketing mix such as product usage rate (e.g., number of printer ink cartridges per year), potential segments can be identified. If the response rates are similar within a segment, and differences in response exist between segments, then promising segments are identified. Segments do not always emerge from these analyses, because in some product-markets distinct segments may not exist, or the segment interrelationships may be so complex that an analysis of these predetermined groupings will not identify useful segments. Product differentiation strategies may be used in these situations.

### *Segmentation Illustrations*

A now-classic study for Mobil (now ExxonMobil) examines buyers in the gasoline market to identify segments. The findings, including information obtained from over 2,000 motorists, are summarized in see Exhibit 3.10. The research identified five primary purchasing groups.[36] Interestingly, the study found that the Price Shopper spent an average of $700 annually, compared to $1,200 for the Road Warriors and True Blues. Mobil's marketing strategy was to offer gasoline buyers a quality buying experience, including upgraded facilities, more lighting for safety, responsive attendants, and quality convenience products. The target segments are Road Warriors and Generation F3, involving a major effort on convenience stores and reduced time at the gas pump based on the Mobil *Speed Pass*. The test results from the new strategy raised revenues by 25 percent over previous sales for the same retail sites.

As shown by the profiles described in see Exhibit 3.10, needs and preferences can vary considerably within a market. Trying to satisfy all of the buyers in the market with the

[36]Allanna Sullivan, "Mobil Bets Drivers Pick Cappuccino Over Low Prices," *Wall Street Journal,* January 30, 1995, B1 and B4.

**EXHIBIT 3.10 Gasoline Buyer Segmentation Model**

Source: Alanna Sullivan, "Mobil Bets Drivers Pick Cappuccino over Low Prices," *The Wall Street Journal*, January 30, 1995, Bl. Wall Street Journal. Central Edition [Staff Produced Copy Only] by Alanna Sullivan. Copyright 1995 by Dow Jones & Co Inc. Reproduced with permission of Dow Jones & Co Inc. in the format Textbook via Copyright Clearance Center.

| Road Warriors: | True Blues: | Generation F3: | Homebodies: | Price Shoppers: |
|---|---|---|---|---|
| Generally higher-income, middle-aged men, who drive 25,000 to 50,000 miles a year . . . buy premium with a credit card . . . purchase sandwiches and drinks from the convenience store . . . will sometimes wash their cars at the carwash. | Usually men and women with moderate to high incomes who are loyal to a brand and sometimes to a particular station . . . frequently buy premium gasoline and pay in cash. | (for fuel, food, and fast): Upwardly mobile men and women—half under 25 years of age—who are constantly on the go . . . drive a lot and snack heavily from the convenience store. | Usually housewives who shuttle their children around during the day and use whatever gasoline station is based in town or along their route of travel. | Generally aren't loyal to either brand or a particular station; and rarely buy the premium line . . . frequently on tight budgets . . . efforts to woo them have been the basis of marketing strategies for years. |
| **16% of buyers** | **16% of buyers** | **27% of buyers** | **21% of buyers** | **20% of buyers** |

same marketing approach is difficult. Analyzing both the customer and the competition is important. Specific competitors may be better (or worse) at meeting the needs of specific customer groups (e.g., Mobil's Road Warriors). Finding gaps between buyers' needs and competitors' offerings provides opportunities for improving customer satisfaction. Also, companies study competitors' products to identify ways to improve their own.

In a completely different sector, one European bank employed a psychologist to examine customers' monthly statements to search for clues to lifestyle and personality profiles. The study identified three customer groups:

- **Hedonistic Grazers**—impulsive and spontaneous people, with a tendency to live for the moment; Bridget Jones characters who are instant pleasure seekers and do not like to postpone fun and extravagance any longer than is absolutely necessary
- **Material Martyrs**—masters of time management and efficiency; control freaks who plan their weekly meals in advance and prefer to buy furniture than to go out; introverted and home loving; careful and frugal
- **Steady Builders**—mature, settled, stable people, with a strong sense of responsibility, who debate a big expense rather than spend spontaneously.[37]

Understanding lifestyle differences is critical to providing financial services tailored to the differences between these groups, since there is a link between lifestyle and the needs for financial services, as well as responsiveness to different offers.

At a broader level, in an era of increased globalization it is also important to recognize that segmentation has an international dimension in many markets. At the simplest level, country differences may dictate the need for variations in the sizes of products like apparel and household furniture based on ethnic identity in overseas countries. However, a strategic approach to segmentation internationally requires deeper analysis. For example, Global brands may be judged on quality, global, and social responsibility characteristics by

[37]"Bank Asks Lying Expert to Study Accounts," *The Sunday Times,* November 19, 2000, 1.

consumers. An international research study suggests segments relating to how consumer relate to global brands are:

- **Global Citizens** (55 percent)—rely on the global success of a company to indicate quality and innovation, but concerned about social responsibility issues. The United States and the UK have relatively few global citizens, but they are more common on Brazil, China, and Indonesia.
- **Global Dreamers** (23 percent)—less discerning about and more fervent in their admiration of transnational companies. They see global brands as quality products and accept the cultural symbols they provide, and are less concerned with social responsibility issues.
- **Antiglobals** (13 percent)—skeptical that transnational companies deliver higher quality goods, and dislike brands that preach American values. Do not trust global companies to behave responsibly, and their brand preferences indicate they try to avoid doing business with transnational firms.
- **Global Agnostics** (9 percent)—do not base purchase decisions on a brand's global attributes, and judge them on the same criteria they use for local brands. Higher numbers in the United States, but lower in Japan, Indonesia, and China.[38]

Nonetheless, it is also important to recognize that one impact of globalization is to reduce some international differences. In some situations, a powerful global segmentation approach may be less about tailoring products to fit the tastes of local consumers in different countries, and more about recognizing the commonality of "global tribes"—subcultures of customers who share very similar outlooks, styles and aspirations despite their different nationalities and languages. For example, teenagers from every continent socialize on the Internet and share tastes in fashion and music. Working women trying to juggle careers and families share challenges and needs which span cultures. Baby boomers are aging and many need hearing aids, but as a group spanning continents they reject products associated with aging, which provides a global challenge for manufacturers of such products.[39]

## Forming Groups Based on Response Differences

The alternative to selecting customer groups based on descriptive characteristics is to identify groups of buyers by using response differences to form the segments. A look at a segmentation analysis for the packaging division of Signode Corporation illustrates how this method is used.[40] The products consist of steel strappings for various packaging applications. An analysis of the customer base identified the following segments: programmed buyers (limited service needs), relationship buyers, transaction buyers, and bargain hunters (low price, high service). Statistical (cluster) analysis formed the segments using 12 variables concerning price and service trade offs and buying power. The study included 161 of Signode's national accounts. Measures of the variables were obtained from sales records, sales managers, and sales representatives. The segments vary in responsiveness based on relative price and relative service.

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[38]Douglas B. Holt, John A. Quelch, and Earl L. Taylor, "How Global Brands Compete," *Harvard Business Review,* September 2004, 68–75.

[39]Carol Hymowitz, "Fitted for Global 'Tribes' Instead of Nationalities," *Wall Street Journal,* December 11, 2007, 33.

[40]V. Kasturi Ranga, Rowland T. Moriarity, and Gordon S. Swartz, "Segmenting Customers in Mature Industrial Markets," *Journal of Marketing,* October 1992, 72–82.

The widespread adoption of CRM systems offers greater opportunity for timely and detailed analysis of response differences between customers. The "data warehouse" by integrating transactional data around customer types, makes possible complex analyses to understand differences in the behavior of different customers groups, to observe customer life-cycles, and to predict behavior.[41] We discuss CRM in Chapter 4.

Response difference approaches draw more extensively from buyer behavior information than the customer group identification methods discussed earlier. Note, for example, the information on Signode's customer responsiveness to price and service. We now look at additional applications to more fully explore the potential of the customer response approaches.

### *Cluster Analysis*

Cluster analysis (a statistical technique) groups people according to the similarity of their answers to questions such as brand preferences or product attributes. This method was useful to form segments for Signode Corporation. The objective of cluster analysis is to identify groupings in which the similarity within a group is high and the variation among groups is as great as possible. Each cluster is a potential segment.

### *Perceptual Maps*

Another segmentation method uses consumer research data to construct perceptual maps of buyers' perceptions of products and brands. The information helps select market-target strategies and decide how to position a product for a market target.

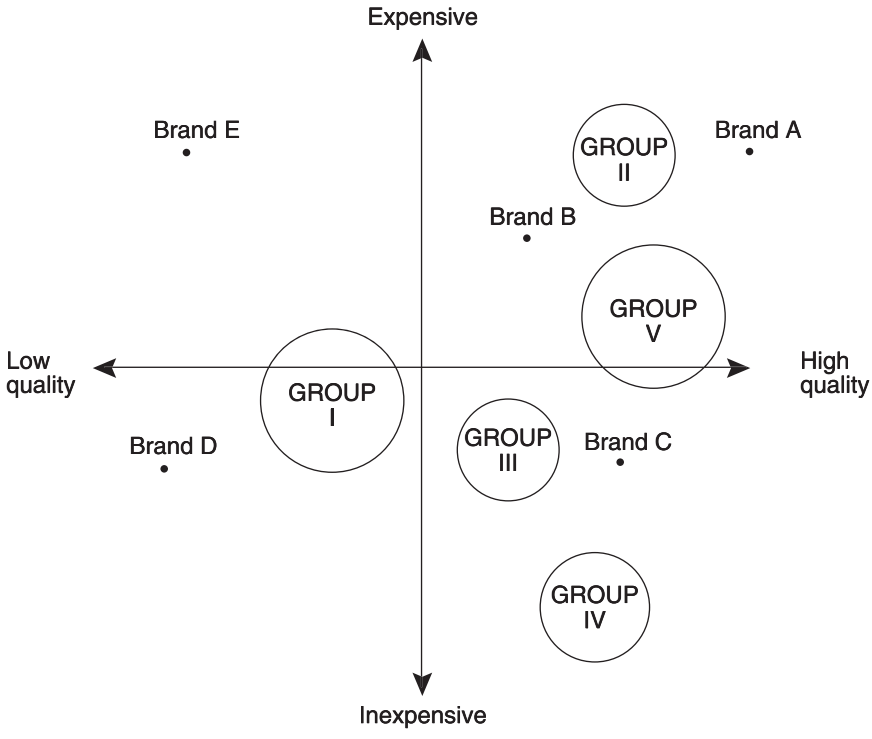
While the end result of perceptual mapping is simple to understand, its execution is demanding in terms of research skills. Although there are variations in approach, the following steps are illustrative:

1. Select the product-market area to be segmented.
2. Decide which brands compete in the product-market.
3. Collect buyers' perceptions about attributes for the available brands (and an ideal brand) obtained from a sample of people.
4. Analyze the data to form one, two, or more composite attribute dimensions, each independent of the other.
5. Prepare a map (two-dimensional X and Y grid) of attributes on which are positioned consumer perceptions of competing brands.
6. Plot consumers with similar ideal preferences to see if subgroups (potential segments) will form.
7. Evaluate how well the solution corresponds to the data that are analyzed.
8. Interpret the results as to market-target and product-positioning strategies.

An example of a perception map is shown in see Exhibit 3.11. Each Group (I–V) contains people from a survey sample with similar preferences concerning expensiveness and quality for the product category. The Brands (A–E) are positioned using the preference data obtained from the survey participants. Assuming you are product manager for Brand C, what does the information indicate concerning possible targeting? Group V is a logical market target and Group III may represent a secondary market target. To appeal most effectively to Group V, we will probably need to change somewhat Group V consumers' price perceptions of Brand C. Offering a second brand less expensive than C to appeal to Group IV

[41] *Financial Times, Understanding Customer Relationship Management* (London: *Financial Times*), Spring 2000.

**EXHIBIT 3.11**
**Consumer Perception Mapping Illustration**




is another possible action. Of course, it is necessary to study the research results in much greater depth than this brief examination of see Exhibit 3.11. Our intent is to illustrate the method of segmenting and show how the results might be used.

Perceptual mapping, like many of the research methods used for segment identification, is time-consuming and represents a technical challenge. When used and interpreted properly, these methods are useful tools for analyzing product-market structure to identify possible market targets and positioning concepts. Of course, there are many issues to be considered in specific applications such as choosing the attributes, identifying relevant products and brands, selecting the sample, and evaluating the strength of results.

## Finer Segmentation Strategies

A combination of factors may help a company utilize finer segmentation strategies. Technology may be available to produce customized product offerings. Furthermore, highly sophisticated databases for accessing buyers can be used, and buyers' escalating preferences for unique products encourage consideration of increasingly smaller segments. In some situations, an individual buyer may comprise a market segment. Thus, an important segmentation issue is deciding how small segments should be. For example, Los Angeles company Drybar is part of a new market niche for specialist hair drying services (no cutting, shampooing, or other services) for females who are very focused on their appearance and willing to regularly outsource their blow-drying needs.[42]

[42]Neel Shah, "Some Like It Hot… and Dry," *Bloomberg BusinessWeek,* March 21–27, 2011, 94–95.

Growing market granularity encourages strategists to consider finer segments. Penn and Zalesne's "microtrends" research suggests growing niches in the U.S. market: growing numbers of home knitters (knitting has become "cool"); decline of baseball fans; increasing population of vegan children, rise of women archers, surge in employees in the not-for-profit sector; trend toward "do-it-yourself doctors" in health care.[43] For example, Penn predicts the prospect of chains of hygienic, upmarket tattoo parlors, as small shifts in tastes and behavior create new possibilities.[44] We consider the logic of finer segments followed by a discussion of the available finer segmentation strategies.

## Logic of Finer Segments

Several factors working together point to the benefits of considering very small segments in some cases, segments of one. These include (1) the capabilities of companies to offer cost effective, customized offerings; (2) the desires of buyers for highly customized products; and (3) the organizational advantages of close customer relationships.

### *Customized Offerings*

The capabilities of organizations to offer customized products is feasible because of extensive information flow and comprehensive data bases, computerized manufacturing systems, and integrated value chains.[45] Database knowledge, computer-aided product design and manufacturing, and distribution technology (e.g., just-in-time inventory) offer promising opportunities for serving the needs and preferences of very small market segments. This technology combined with the Internet has led to the emergence of "sliver" companies or "micromultinationals"—small, flexible organizations selling highly specialized products across the world. For example, with products that can be digitized and delivered online—for example, computer software, music collections, financial services like travel and auto insurance, e-books—there is already capacity for almost infinite customization.

### *Diverse Customer Base*

The requirements of an increasingly diverse customer base for many products are apparent. For example, the international automobile industry is facing the challenge of the Three Day Car Program—allowing the buyer to specify the detail and design choices of a vehicle online, the order stimulates production, with delivery 3 days later. This program has been designed because of the diversity in customer preferences in autos, and the sheer number of variants included in modern vehicles.

### *Close Customer Relationships*

Companies recognize the benefits of close relationships with their customers. By identifying customer value opportunities and developing cost-effective customized offerings, relationships can be profitable and effective in creating competitive barriers.

## Finer Segmentation Strategies

We examine three approaches for finer segmentation opportunities: microsegmentation, mass customization, and variety seeking.[46] (Mass customization is discussed further in Chapter 8.)

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[43]Mark J. Penn and E. Kinney Zalesne, *Microtrends: The Small Forces Behind Tomorrow's Big Changes* (New York: Hachette), 2008.

[44]Sarah Baxter, "Microtrends Are Taking Over the World," *Sunday Times,* August 26, 2007, S1, 24.

[45]Ali Kara and Erdener Kaynak, "Markets of a Single Customer: Exploiting Conceptual Developments in Market Segmentation," *European Journal of Marketing,* No. 11/12, 1997, 873–895.

[46]Barbara E. Kahn, "Dynamic Relationships with Customers: High-Variety Strategies," *Journal of the Academy of Marketing Science,* Winter 1998, 45–53.

### *Microsegmentation*

This form of segmentation seeks to identify narrowly defined segments using one or more of the previously discussed segmentation variables (see Exhibit 3.7). It differs from more aggregate segment formation in that microsegmentation results in a large number of very small segments. Each segment of interest to the organization receives a marketing mix designed to meet the value requirements of the segment.

### *Mass Customization*

Providing customized products at prices not much higher than mass-produced items is feasible using mass customization concepts and methods. Achieving mass customization objectives is possible through computer-aided design and manufacturing software, flexible manufacturing techniques, and flexible supply systems.

### *Variety-Seeking Strategy*

This product strategy is intended to offer buyers opportunities to vary their choices in contrast to making unique choices.[47] The logic is that buyers who are offered alternatives may increase their total purchases of a brand. Mass customization methods also enable companies to offer an extensive variety at relatively low prices, thus gaining the advantages of customized and variety offerings.

### *Finer Segmentation Issues*

While the benefits of customization are apparent, there are several issues that need to be examined when considering finer segmentation strategies:[48]

1. How much variety should be offered to buyers? What attributes are important in buyers choices and to what extent do they need to be varied?
2. Will too much variety have negative effects on buyers? It is possible that buyers will become confused and frustrated when offered too many choices?
3. Is it possible to increase buyers' desire for variety, creating a competitive advantage?
4. What processes should be used to learn about customer preferences? This may involve indirect methods (e.g., database analysis), or involving buyers in the process.

High-variety strategies, properly conceived and executed, offer powerful opportunities for competitive advantage by providing superior value to customers. As highlighted by the above issues, pursuing these finer segmentation strategies involves major decisions including which strategy to pursue and how to implement the strategy. Important in deciding how fine the segmentation should be is estimating the value and cost tradeoffs of the relevant alternatives.

## Selecting the Segmentation Strategy

We have considered several approaches to market segmentation, ranging from forming segments via experience and judgment to finer segmentation strategies. We now discuss deciding how to segment the market, and strategic analysis of the segments that have been identified.

[47]Kahn, "Dynamic Relationships."
[48]Kahn, "Dynamic Relationships."

## Deciding How to Segment

The choice of a segmentation method depends on such factors as the maturity of market, the competitive structure, and the organization's experience in the market. The more comprehensive the segmentation process, the higher the costs of segment identification will be, reaching the highest level when field research studies are involved and finer segmentation strategies are considered. It is important to maximize the available knowledge about the product-market. An essential first step in segmentation is analyzing the existing customer base to identify groups of buyers with different response behavior (e.g., frequent purchase versus occasional purchase). Developing a view of how to segment the market by managers may be helpful. In some instances this information will provide a sufficient basis for segment formation. If not, experience and existing information are often helpful in guiding the design of customer research studies.

The five segmentation criteria discussed earlier help to evaluate potential segments. Deciding if the criteria are satisfied rests with management after examining response differences among the segments. The segmentation plan should satisfy the responsiveness criterion plus the other criteria (end-users are identifiable, they are accessible via marketing program, the segment(s) is economically viable, and the segment is stable over time). The latter criterion may be less of an issue with mass customization since changes can be accommodated. Segmentation strategy should not be static. The competitive advantage gained by finding (or developing) a new market segment can be very important.

## Strategic Analysis of Market Segments

Each market segment of interest needs to be studied to determine its potential attractiveness as a market target. The major areas of analysis include customers, competitors, positioning strategy, and financial and market attractiveness.

### *Customer Analysis*

When forming segments, it is useful to find out as much as possible about the customers in each segment. Variables such as those used in dividing product-markets into segments are also helpful in describing the people in the same segments. The objective is to find descriptive characteristics that are highly correlated to the variables used to form the segments. Standardized information services are available for some product-markets including foods, health and beauty aids, and pharmaceuticals. Large markets involving many competitors make it profitable for research firms to collect and analyze data that are useful to the firms serving the market. We discuss marketing information resources in Chapter 5.

An essential part of customer analysis is determining how well the buyers in the segment are satisfied. Customer satisfaction depends on the perceived performance of a product and supporting services and the standards that customers use to evaluate that performance.[49] The customer's standards complicate the relationship between organizational product specifications (e.g., product attribute tolerances) and satisfaction. Standards may involve something other than prepurchase expectations such as the perceived performance of competing products. Importantly, the standards are likely to vary across market segments.

[49]The following discussion of customer satisfaction is based on discussions with Robert B. Woodruff, The University of Tennessee, Knoxville.

### *Competitor Analysis*

Market segment analysis considers the set of key competitors currently active in the market in which the segment is located plus any potential segment entrants. In complex market structures, mapping the competitive arena requires detailed analysis. The competing firms are described and evaluated to highlight their strengths and weaknesses. Information useful in the competitor analysis includes business scope and objectives; market position; market target(s) and customer base; positioning strategy; financial, technical, and operating strengths; management experience and capabilities, and special competitive advantages (e.g., patents). It is also important to anticipate the future strategies of key competitors.

Value chain analysis can be used to examine competitive advantage at the segment level. A complete assessment of the nature and intensity of competition in the segment is important in determining whether to enter (or exit from) the segment and how to compete in the segment. Competitor and value chain analysis are discussed in Chapter 2.

### *Positioning Analysis*

We consider positioning strategy in Chapter 6. Segment analysis involves some preliminary choices about positioning strategy. One objective of segment analysis is to obtain guidelines for developing a positioning strategy. Flexibility exists in selecting how to position the firm (or brand) with its customers and against its competition in a segment. Positioning analysis shows how to combine product, distribution, pricing, and promotion strategies to favorably position the brand with buyers in the segment. Information from positioning maps like see Exhibit 3.11 is useful in guiding positioning strategy. The positioning strategy should meet the needs and requirements of the targeted buyers at a cost that yields a profitable margin for the organization.

### *Estimating Segment Attractiveness*

The financial and market attractiveness of each segment needs to be evaluated. Included are specific estimates of revenue, cost, and segment profit contribution over the planning horizon. Market attractiveness can be measured by market growth rate projections and attractiveness assessments made by management.

Financial analysis obtains sales, cost, and profit contribution estimates for each segment of interest. Since accurate forecasting is difficult if the projections are too far into the future, detailed projections typically extend 2 to 5 years ahead. Both the segment's competitive position evaluation and the financial forecasts are used in comparing segments. In all instances the risks and returns associated with serving a particular segment need to be considered. Flows of revenues and costs can be weighted to take into account risks and the time value of revenues and expenditures.

It should be recognized that as information availability grows, for example through the data warehouses associated with CRM systems, the evaluation of segment attractiveness also has the potential for identifying unattractive market segments and even individual customers, which may be candidates for deletion. There may also be ethical considerations which limit the attractiveness of certain segments. The ETHICS APPLICATION describes some of the issues surrounding targeting children (or some groups of children), and some of the undesirable practices that have emerged. The potential for damage to brand and corporate reputation in such situations is considerable.

## Ethics Application *Targeting Children*

Segmentation studies for many markets identify children as a high-value opportunity. Disney, with its Club Penguin, and Viacom have invested heavily to capture the audience of children on the Web. Disney has extended "princess mania" to outfits for 3- to 6-year-old girls. Confectionery, fast food, music, and toys are also illustrative. Another example is Sweet & Sassy, based in Southlake, Texas, which provides spas offering manicures and facials for five to twelve year old children.

It is well-known that children exhibit great "pester power" influencing their own consumption and that of the family.

Parents and health advisors across the world warn of the dangers of childhood obesity. For food firms, an ethical dilemma or targeting this segment concerns the impact of their marketing actions on the young.

If accepted as proper market targets, ethical questions surround the ways in which advertisers reach young consumers with promotional messages, in ways which get around parental controls and conventional media:

- Reports in Europe suggest some advertising agencies use Internet chat rooms to place commercial messages to reach young consumers, getting around strict rules concerning advertising to children.
- Food companies have been accused of using text messaging (SMS), websites, and viral marketing campaigns to sell products to children.
- Some advertising agencies run focus group research with consumers as young as 3 years old, to establish ways to channel "pester power" onto family purchasing.
- Aggressive and invasive promotion stands accused of creating child "shopaholics" operating as undercover sales agents for brands.

**Sources:** Glen Owen, "Scandal of the Advertisers Who Pose As Young Girls on Internet Chatrooms," *Daily Mail*, April 2, 2006, 27. Jenny Wiggins, "Food Industry Criticised Over Tactics to Tempt Children," *Financial Times*, January 31, 2006, 5. Louise Lee "What Next, Bubblegum Botox?" *BusinessWeek*, July 2, 2007, 18. Rushe, Dominic, "Hooking the Kids with the Internet," *Sunday Times*, November 18 2007, S3, 7. Merissa Marr, "Disney Extends Princess Mania to the Crib," *Wall Street Journal*, November 22, 2007, 27. Ed May and Agnes Nairn, Consumer Kids: How Big Business Is Grooming Our Children for Profit (London: Constable), 2009.

### *Segment "Fit" and Implementation*

One important aspect of evaluating segment attractiveness is how well the segments match company capabilities and the ability to implement marketing strategies around those segments.[50] There are many organizational barriers to the effective use of segmentation strategies. New segment targets that do not fit into conventional information reporting, planning processes, and budget systems in the company may be ignored or not adequately resourced. Innovative models of customer segments and market opportunities may be rejected by managers or the culture of the organization.

There are dangers that managers may prefer to retain traditional views of the market and structure information in that way, or that segmentation strategy will be driven by existing organizational structures and competitive norms.[51] It is important to be realistic in balancing the attractiveness of segments against the ability of the organization to implement appropriate marketing strategies to take advantage of the opportunities identified. Building

[50]Nigel F. Piercy and Neil A. Morgan, "Strategic and Operational Segmentation," *Journal of Strategic Marketing,* 1(2), 1993, 123–140.

[51]Noel Capon and James M. Hulbert, *Marketing Management in the 21st Century* (New Jersey: Prentice-Hall, 2001), 185–186.

effective marketing strategy around market segmentation mandates an emphasis on actionability as well as technique and analysis.[52]

Many of the issues we consider in later chapters impact on the operational capabilities of a company to implement segmentation strategies, for example, strength in cross-functional relationships may be a prerequisite to deliver value to new segments; the ability to work with partners may be needed to develop new products to build a strong position in a key market segment. The existence of these capabilities, or the ability to develop them should be considered in making segmentation decisions.

### *Example of Segment Attractiveness Analysis*

An illustrative market segment analysis is shown in see Exhibit 3.12. A 2-year period is used for estimating sales, costs, contribution margin, and market share. Depending on the forecasting difficulty, estimates for a longer time period can be used. When appropriate, estimates can be expressed as present values of future revenues and costs. Business strength in see Exhibit 3.12 refers to the present position of the firm relative to the competition in the segment. Alternatively, it can be expressed as the present position and an estimated future position, based upon plans for increasing business strength. Attractiveness is typically evaluated for some future time period. In the illustration a 5-year projection is used.

The example shows how segment opportunities are ranked according to their overall attractiveness. The analysis can be expanded to include additional information such as profiles of key competitors. The rankings are admittedly subjective since decision makers will vary in their weighing of estimated financial position, business strength, and segment attractiveness. Place yourself in the role of a manager evaluating the segments. Using the information in see Exhibit 3.12, rank segments X, Y, and Z as to their overall importance as market targets. Unless management is ready to allocate a major portion of resources to segment Z to build business strength, it is a candidate for the last-place position. Yet Z has some attractive characteristics. The segment has the most favorable market attractiveness of the three, and its estimated total sales are nearly equal to Y's for the next 2 years. The big problem with Z is its business strength. The key question is whether Z's market share can be increased. If not, X looks like a good prospect for top rating, followed by Y, and by Z. Of course, management may decide to go after all three segments.

**EXHIBIT 3.12**
**Segment Attractiveness Analysis**

| | Segment | | |
|---|---|---|---|
| **Estimated ($ millions)** | **X** | **Y** | **Z** |
| Sales* | 10 | 16 | 5 |
| Variable costs* | 4 | 9 | 3 |
| Contribution margin* | 6 | 7 | 2 |
| Market share† | 60% | 30% | 10% |
| Total segment sales | 17 | 53 | 50 |
| Segment position: | | | |
| Business strength | High | Medium | Low |
| Attractiveness‡ | Medium | Low | High |

*For a two-year period.
†Percent of total sales in the segment.
‡Based on a five-year projection.

[52]D. Young, "The Politics Behind Market Segmentation," *Marketing News,* October 21, 1996, 17.

## Summary

Because buyers differ in their preferences for products, finding out what these preferences are and grouping buyers with similar needs is an essential part of business and marketing strategy development. Market fragmentation and granularity characterize many mature markets. Effective segmentation is key to market-driven strategy, linking strategic issues with the management of resources and operations around segment targets. Segmentation links value opportunities in the market and new market spaces to a company's capabilities to achieve a strong strategic positioning.

Segmentation demands close attention to market definition, identifying market segments and forming segment targets, which are described, analyzed and evaluated. Segmentation of a product-market requires that response differences exist between segments, and that the segments are identifiable and stable over time. Also, the benefits of segmentation should exceed the costs. The variables useful as bases for forming and describing segments include the characteristics of people and organizations, use situation, buyers' needs and preferences, and purchase behavior.

Segments can be formed by identifying customer groups using the characteristics of people or organizations. The groups are analyzed to determine if the response profiles are different across the candidate segments. Alternatively, customer response information can be used to form customer groupings and then the descriptive characteristics of the groups analyzed to find out if segments can be identified. Several examples of segment formation are discussed to illustrate the methods that are available for this purpose.

Finer segmenting strategies present attractive options for moving toward small segments and responding to buyers' unique value requirements. Technology, buyer diversity, and relationship opportunities are the drivers of finer segmentation strategies. These strategies include microsegmentation, mass customization, and variety seeking. While potentially attractive finer segmentation strategies are more complex than other forms of segmentation and require comprehensive benefit and cost evaluations.

Segment analysis and evaluation consider the strengths and limitations of each segment as a potential market target for the organization. Segment analysis includes customer descriptions and satisfaction analysis, evaluating existing and potential competitors and competitive advantage, marketing program positioning analysis, and financial and market attractiveness. Segment analysis is important in evaluating customer satisfaction, finding new-product opportunities, selecting market targets, and designing positioning strategies. Nonetheless, it is also important to understand the organizational barriers to implementing segmentation strategy which may exist in a company, and to evaluate the "fit" of segmentation with company capabilities. Effectively implemented, a good segmentation strategy creates an important competitive edge for an organization.

## Questions for Review and Discussion

1. Competing in the single European market raises some interesting market segment questions. Discuss the segmentation issues regarding this multiple-country market.
2. Why are there marketing strategy advantages in using demographic characteristics to break out product-markets into segments?
3. The real test of a segment formation scheme occurs after it has been tried and the results evaluated. Are there ways to evaluate alternative segmenting schemes without actually trying them?
4. Suggest ways of obtaining the information needed to conduct a market segment analysis.
5. Why may it become necessary for companies to change their market segmentation identification over time?

6. Is considering segments of one buyer a reality or a myth? Discuss.
7. Is it necessary to use a unique positioning strategy for each market segment targeted by an organization?
8. Under what circumstances may it not be possible to break up a product-market into segments? What are the dangers of using an incorrect segment formation scheme?
9. What are some of the advantages in using mass customization technology to satisfy the needs of buyers?
10. Does the use of mass customization eliminate the need to segment a market?

## Internet Applications

A. Explore several of the following websites

www.adquest.com

www.americanet.com

www.autosite.com

www.mlm2000.com

www.sidewalk.com

www.monster.com

www.realtor.com

` How does the information from these sites affect our traditional concept of market segmentation? How is the segmentation process altered by such Internet providers?

B. Evaluate the following site for additional ideas and material concerned with market segmentation and the types of support that can be provided for companies:

www.marketsegmentation.co.uk

## Applications

A. Review the material in the INNOVATION APPLICATION "New Lifestyle Segments for Luxury Hotels." Do these new ventures represent a robust segmentation strategy? What other segment opportunities can be identified in the luxury hotel business? How could these be exploited?

B. Review the BMW Mini case in the GLOBAL APPLICATION "The BMW Mini." Do you believe that BMW has built a robust niche or segment strategy, or is the car a fashion item with limited lasting appeal to car buyers, like other "retro" attempts?