Using Choice-Based Market Segmentation to Improve Your Marketing Strategy

Dr. Bruce Isaacson, President of MMR Strategy Group
Dominique Romanowski, Vice President of MMR Strategy Group
Why Conduct Market Segmentation?

Segmentation studies are complex and expensive undertakings that often come with high expectations. Typically, segmentation studies are initiated because chief marketing officers and other C-suite executives want a road map to guide the growth and strategies of brands and businesses.

When done properly, the results of a segmentation study can indeed provide a plan for development in areas such as marketing, brand strategy and positioning, product development, sales, and distribution. Unfortunately, segmentation studies do not always deliver those benefits. We’ve described some of the problems that can occur with segmentation in another article, entitled “Pitfalls of Market Segmentation and How to Avoid Them”. This article focuses on the issue of “how.” It describes some concrete steps you can undertake, before starting a segmentation study, to maximize your chances of ending up with actionable results and a path for future growth.
This paper draws on MMR Strategy Group’s experience to first describe the basic principles behind all segmentation studies. In particular, we will explain the benefits of using segmentation to make choices in resource allocation. We then will describe a five phase choice-based process to guide segmentation. Finally, we will describe the types of output that your segmentation should provide so it is not just a theoretical research exercise, but an applied exercise in strategy and resource allocation.

**What is Segmentation? What Should It Do?**

Before discussing how segmentation should be conducted, it is worthwhile to take a minute to explain how segmentation works. There are three principles that underlie effective segmentation:
1. **Segmentation is the search for groups that are similar to each other and different from other groups.**

Segmentation is the search for like groups, or segments, within a given marketplace. The members of a segment should be sufficiently similar to each other that they can be targeted in similar ways, and sufficiently different from members of other segments that they should be targeted in ways that are different from other segments.

An old expression describes segmentation as the search for elements in a marketplace that are “homogeneous within, heterogeneous between” – in other words, similar within a segment, but each segment should be different from the other segments. The heart of any segmentation exercise is the search for variables that appropriately distinguish between segments, yet are useful to use for marketing and strategy.
2. **Segmentation is an exercise in making choices about resource allocation.**

   We believe that segmentation should be viewed not just as research to understand consumers and markets, but rather as an exercise in allocating scarce resources. Those resources are the elements that managers apply in marketing and sales activities, such as advertising spending, sales force time, or promotional dollars.

   If segmentation should focus on making choices about how to allocate resources, it makes sense that the segmentation should be designed to identify factors that indicate the best opportunities to invest for growth.

   Segmentation is most helpful when it supports decisions about how to go to market. The elements that support those decisions must be designed into the segmentation from the start.
3. **Segmentation is an exercise that combines analytics, judgment, and experience.**

   A wide variety of analytic tools have been developed to support segmentation. These tools enable and support data collection, cross tabulations, statistical testing, and even the development of presentation materials. They do not, however, replace judgment and experience, and in some ways they can detract from the real focus of segmentation, which is making choices about how to go to market.

   There are many different ways to conduct segmentation, and every segmentation study has more than one solution that could potentially be correct. Which is the right solution? It’s the one that is analytically sound and resonates with the culture and needs of the organization that will use it. Good analytics are necessary but not sufficient – they must be augmented with sound managerial judgment and seasoned experience.

   The next section describes how segmentation should be conducted.
Conducting Choice-Based Segmentation

The elements that support choice-based segmentation, and that make segmentation practical and meaningful, must be designed into the process before the study begins. Figure 1 shows MMR Strategy’s process for choice-based segmentation. This process is organized into five phases.

Figure 1: The Five Phases of Choice-Based Marketing Segmentation
Phase 1: Initial discussions with key stakeholders and customers

Choice-based segmentation should start with discussions with the key stakeholders who will use the research. The discussions will set objectives and expectations for the study. Most segmentation projects start by listing questions than can be answered in a single study, and discussions at this stage will identify the most important issues.

The initial discussions should include key stakeholders across multiple functions and layers of the company. Ideally, the process also includes input from customers, non-customers, and possibly distribution partners, to further refine the scope of the research and identify variables to measure. There are a variety of ways to conduct these discussions, such as:

- One-on-one interviews with key executives
- Workshops or group discussions with key stakeholders
- Qualitative research, such as focus groups, with customers, agents, distributors, or resellers.

A segmentation project may include some or all of these discussion elements.
The questions asked in this stage will drive the later focus of the segmentation, and are intended to identify key concerns, questions, and hypotheses. They might include questions such as the following:

a. **Customers**: Who is our core customer? Who should we target?

b. **Buying Behavior**: Where do our consumers shop and buy? Where do they want to shop and buy?

c. **Needs**: What are the core needs of our customers, both met and unmet?

d. **Brand image**: What is the current image of our brand? Why and when is our brand considered or purchased, and when are we not considered?

e. **Competition**: Who are our key competitors? How are they positioned, and how are they viewed by customers?

f. **Behaviors**: What other marketplace behaviors drive buying patterns and marketplace dynamics?

g. **Data**: What data do we currently use to make marketplace decisions? Do we use any outside databases to drive activities such as sales prospecting, direct mail, or media buying, and should those databases be linked to the segmentation?
The answers to these questions will later guide resource allocation in areas such as marketing, distribution, and product development.

**Phase 2: Gather the segmentation database.**

This phase includes gathering the segmentation database. There will be many decisions to make in this phase, such as determining what to measure, deciding who to survey, writing a survey questionnaire, and administering the survey, and creating the segmentation database. These decisions should be focused around the questions, hypotheses, and concerns identified in the first phase.

A few principles that will support good practices in this phase include the following:

- The results of the activities in the prior phase should be discussed and agreed upon before Phase 2 data gathering is started.
- Before writing the survey questionnaire, develop a questionnaire outline, which lists the variables that will be gathered without details such as skip patterns and complex scales. Senior managers and subject matter experts can react more readily to an outline than to a detailed questionnaire.
How big of a survey database should you gather? A rule of thumb is to gather at least 200 interviews for every major segment you wish to analyze. The smallest groups that can be analyzed will typically have about 75 respondents per group. Most of the time, this means that most segmentations will have at least 500-750 interviews and usually more than 1,000 interviews. Larger segmentations, used by multiple divisions or functions across an organization, may have more than 2,000 interviews.

The survey should be comprehensive, inclusive of a wide range of variables that may be useful or interesting. However, the need to explore a range of questions should be balanced with the necessity to keep the interview short enough so that respondents pay attention throughout. Our experience is that survey questionnaires that take longer than 20 to 25 minutes are too long.

The survey database may also need to link to variables that will be appended from other sources and used in specific activities such as sales prospecting, direct mail, or media buying. These appended variables will be analyzed together with the survey data.

The segmentation database will age over time and will need to be refreshed or updated as consumers, markets, or business needs change.
Phase 3: Discover key segments

The third phase analyzes the survey database to discover key segments that exist in the marketplace. Typically, segments can be created based on three different types of variables, each of which has different strengths:

a. **Demographics:** Customer demographics include variables such as age, income, or gender. Demographics are easy to understand and relatively easy to identify and target in activities such as media buying, direct marketing, or sales planning. However, two households may have very similar demographics but very different lifestyles, behaviors, and needs. Compared with other types of variables, demographics are easier to target but not as powerful in creating segments.

b. **Behaviors:** Behavioral variables describe what customers do, such as brand switching behavior, usage habits, or shopping activities. These variables can be sensible and useful. In a segmentation conducted for a fast food Mexican restaurant chain, it is sensible to target consumers who eat fast food and who eat Mexican food. Similarly, in industrial markets, segmentation for a health care imaging device might target hospitals that use similar imaging technologies. Customer behaviors are used most often in segmentations of business-to-business markets, where sales efforts can identify the behaviors of individual customer accounts.
c. **Needs:** These variables describe customers’ wants, attitudes, and emotions towards the product category and towards items related to the product category.

For example, it makes sense for an insurance company to target consumers who prefer to have a lot of insurance coverage. Or, a roadside assistance company may want to target customers who like to plan ahead.

Compared with the other variables, needs-based segmentations tend to be very good ways to distinguish one segment from another, and they show very good discrimination in segmentation analysis. Customer needs are often highly correlated with behaviors – for example, consumers who want to have a lot of insurance coverage may have certain other behaviors, such as long-term relationships with insurance agents.

While customer needs are powerful and frequently used in segmentation, they can be more difficult to target in sales efforts and media buying than variables such as demographics.
Given the range of variables to consider for creating a segmentation scheme, a few principles will support good practices in this phase:

- The best segmentation typically starts with all three types of variables, including demographics, behaviors, and needs.
- The choice across the three types of variables depends in part upon the needs of the client. A segmentation used primarily by a marketing department may be different than a segmentation used primarily by a sales force.
- Segmentation may use statistics and analytics, including methods such as cross tabulations, correlations, factor analysis, and cluster analysis. These methods are useful, but must be used in combination with judgment and experience to develop the right segmentation solution.
Phase 4: Set segment priorities

The fourth phase sets segment priorities, which is done primarily by sizing and describing key segments.

**Sizing** refers to measuring the size of the segment, and can be done using a variety of measures, including market share, sales and profits. Ideally, the segmentation should be sized with measures related to both sales and profits. A segment that represents a high percentage of the market, such as price-oriented shoppers, may represent high sales but not necessarily a high percentage of potential profits. Conversely, niche segments may be able to provide high profits but not represent a high percentage of sales or market share.

In addition to sizing, the segments should also be described. Whether the segments were created using demographics, behaviors, or needs, they are often described using all three types of variables. For example, if a segmentation for a cable television service provider has identified a group of consumers who share the behavior of watching most high definition programming, Phase 4 can now identify the demographics and attitudes that those consumers tend to have. The demographics can later be used to develop strategies to target those consumers with marketing and sales activities.
Figure 2 uses a disguised example based on a fictional supermarket retailer to show how multiple variables can be used to describe segmentation. The segmentation of this retailer revealed four customer segments. Figure 2 presents a summary chart to describe the four segments, using variables relating to demographics, behaviors, and needs to evaluate the value of targeting the segment. In other words, segments built with one type of variable can be described with many different types of variables.

Figure 2: Segment Descriptions

<table>
<thead>
<tr>
<th>Segment name</th>
<th>Percent of population</th>
<th>Profile</th>
<th>Key needs</th>
<th>Value of targeting segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Segment 1: Challenged Food Lover</td>
<td>21%</td>
<td>Younger, married, higher income, doesn’t mind shopping, very busy, no time to cook, loves food.</td>
<td>Quality, convenience, and atmosphere.</td>
<td>High. Shops less frequently and smallest segment. Will pay premium for quality, convenience and service. Likes Le Panier.</td>
</tr>
<tr>
<td>Segment 3: Homemaker on a Budget</td>
<td>38%</td>
<td>Lower income, female, married with kids, frequent shopper.</td>
<td>Price, value and quality.</td>
<td>Moderate. Large group, good frequency but more sensitive to price than quality or service.</td>
</tr>
<tr>
<td>Segment 4: It’s a Daily Drag</td>
<td>27%</td>
<td>Younger, lower income, male, shops the least possible.</td>
<td>Convenience and price.</td>
<td>Low. Shops the least frequently. Low involvement in category. Just get whatever and go.</td>
</tr>
</tbody>
</table>
Good practices in Phase 4 focus on looking for segments that are both meaningful and actionable. A segment is meaningful if it is based on attributes that matter to customers, while a segment is actionable if it can be reached and targeted by the company.

As can be seen in Figure 3, a segmentation that is meaningful but not actionable cannot be targeted, while a segmentation that is not meaningful but is actionable is irrelevant to consumers. Problems with segmentation most often fall in the upper left quadrant of Figure 3, as companies too often use segmentations that are based on convenience – easy for the company to target, but not based on criteria that describe meaningful differences across customer segments.

Figure 3: The relationship between meaningful and actionable segmentations

<table>
<thead>
<tr>
<th>Is the Segmentation Meaningful for Customers?</th>
<th>Not Meaningful</th>
<th>Meaningful</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the Segmentation Actionable for the Company?</td>
<td>Actionable</td>
<td>Relevant and targetable</td>
</tr>
<tr>
<td></td>
<td>Not Actionable</td>
<td>Irrelevant and cannot be targeted</td>
</tr>
</tbody>
</table>
There are often tradeoffs between meaningful and actionable. Segmentation based on conceptual variables such as needs can be highly meaningful, but not as actionable, because they rely on variables that are more difficult to target in the marketplace. By contrast, a simpler segmentation based on demographics may be easier to use, but less meaningful to consumers. This is a common tradeoff that companies will evaluate differently according to their culture and needs.

One other good practice worth noting is the close connection between the different phases. As segments are discovered, they are analyzed and described. If the segments cannot be described as meaningful and actionable, then there may be a need to go back to Phase 3 to discover additional segments.

**Phase 5: Develop segment strategies**

Phase 5 is a critical and often overlooked phase of segmentation projects. While earlier phases focus primarily on *where* to compete, Phase 5 focuses on *how* to compete. In other words, Phase 5 turns the segmentation analysis into a series of useful tools to support strategic decisions about businesses and brands.
We mentioned earlier that segmentation should be seen as an exercise in making choices to guide resource allocation. After making one important set of choices, where to focus, Phase 5 makes a second set of choices, namely how to approach the areas of focus.

The segment strategies developed in Phase 5 will make choices to answer questions such as the following:

- **Brand Image and Positioning**: What will our brand image be? What positioning will we adopt to best appeal to prospects in the target segment?
- **Product**: What types of products and services will appeal to prospects in the target segment?
- **Pricing**: How will the products be priced? Will the company use a premium pricing strategy, or one focused on market penetration and volume?
- **Marketing Mix and Communications**: What marketing mix will be used to support the desired positioning? Will the marketing focus on direct or mass media? Offline or online activities? What messages will the marketing seek to communicate?
- **Distribution**: How will the company go to market? What type of distribution channels will be used, including retailers, intermediaries, and resellers?
- **Sales**: What type of sales efforts will be used to target distributors and/or customers in the target segments?
Of all the above activities, brand image and positioning are the most important. They are also difficult to develop, and often not given sufficient thought or attention. When done correctly, segmentation analysis provides a foundation of data and insight that can be used to develop brand positioning. Knowledge of the demographics, behaviors and needs of each segment can be used to create very powerful positioning statements that will guide segment strategies.

Figure 4 shows an example of a template that can be used to develop a positioning statement. As shown in the figure, the core elements of any positioning statement include identifying the target customer, describing the need that our products or services will meet, indicating the unique benefits we offer, and describing the reasons why our offering is better.

**Figure 4: Template for Positioning Statement**

**Overview of Positioning Statements**

- The best positioning statements define benefits that are clear, compelling, and distinct relative to competition.

- **For...**
  - Indicates who the target customer is.

- **Who...**
  - Indicates what qualifies the target customer and what need draws the consumer to us.

- **Our product or service offers...**
  - Indicates the unique or distinct benefits that our products or services offer.

- **Because...**
  - Indicates how our product or service is better than the competition.

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Developing positioning statements are a difficult and important exercise, made possible only with good data. One of the key outputs often used to create a positioning statement is a quadrant map. This map displays the specific attributes where consumers are more or less satisfied with the company’s offerings, and also shows the relative importance of those satisfaction ratings. An example is provided in Figure 5, again using the supermarket example.

**Figure 5: Quadrant map used to develop positioning statement**
Attributes that show up in the top right are major strengths – important to consumers and areas of strength for our fictitious retailer. Those are the areas where companies often chose to focus. A company may also choose to focus on the upper left quadrant, which shows attributes important to consumers. Focusing on any of those attributes will require effort to turn low-rated attributes into attributes that are rated more highly.

A good practice in Phase 5 is to work across the organization so all functions are involved in developing a coherent set of strategies in support of the segmentation. This is often done with a series of workshops to discuss the results of the segmentation and develop segment strategies.
If your segmentation uses this five phase approach, our experience suggests that you will increase the chances that your segmentation supports the type of strategic choices that enable good decisions in strategy, marketing and sales. Specifically, the odds will be greater that your segmentation:

- provides segments that are actionable and meaningful,
- resonates with other functions across the organization, and
- links to a detailed go-to-market plan.

**About MMR Strategy Group**

MMR Strategy Group is a full-service market research-based consulting firm. We help our clients grow by leveraging customer insight to develop marketing and sales strategies. In order to support critical business decisions, we combine the data gathering capabilities of a research firm with the business analytics of a strategic consulting firm.

For more information about segmentation, please contact us at 818.464.2400 or email info@mmrstrategy.com.

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