**Abstract**

This data science project aims to use machine learning to analyze mall customer spending by way of

segmenting those customers in various ways. Customer segmentation is a useful mechanism for

businesses to have at their fingertips. Companies can utilize such methods to target their consumers

based on spending behaviors, gender, age, and many more characteristics. The goal is to find your

“best” customer, depending upon what the situation may be. Using this targeted information to create

adapted marketing efforts, they increase their chances of appealing to that grouping of customers. One

of the best ways to attempt this type of method is by using what is called a K-means algorithm. This

algorithm is ideal for clustering unlabeled data, or data lacking a predefined groups or categories, which

is what we will be working with. K-means works to separate data into not only relevant groups, but the

appropriate number of groups as well. This allows the groupings to be made organically. Not only is this

a powerful algorithm for analyzing customer behavior, but it has business implications in terms of

inventory management, bot detection, and more. One can monitor data once it has been sorted into a

group; For example, if a specific data point changes its label over time, this could represent a meaningful

signal. The data being used for this project consists of customer information for a business, and it comes

from a research page where data has been collected for project purposes.

**Data Pre-Processing and Exploration**

The data set that I have used consists of customer information for a shopping mall. The features

included are age, gender, annual income, and spending score. Each customer is assigned a Customer ID

for identification purposes. The spending score is a value provided for each customer which helps us to

define their spending behavior. A customer who spends more has a higher score than one who spends

less. There is a total of 200 observations in our data set. The file we are working with is named

Mall\_Customers.csv which contains all of our data.

The best way to begin to familiarize ourselves with the data is by running a couple of overview

functions on the features. We will run the head and summary function on the entire set, and then

continue by running these functions for some of the specific features (such as Age and Income Level) as

well as look at the standard deviations for each. Running the str() function on the data set also gives us a

general look at how it is laid out and the type of features we are going to be dealing with.

One great visualization for this data set will be to look at the gender distribution since we have

this information for our customers. We can do this by creating a simple bar plot and we see that the

number of female customers is higher than male customers. We can visualize this feature in a slightly

different way by using a pie chart to show the ratio between the two genders (Figure 1). From our pie

chart we know that the percentage of females is 56% while the percentage of males in the customer

dataset is 44%.

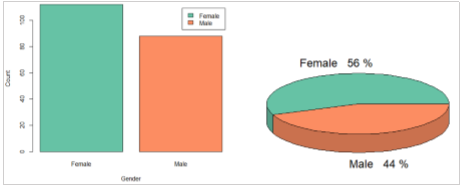


Figure 1: Distribution of Feature gender

The next feature we want to take a closer look at is customer age. We can look at the age

distribution of our customer base by first viewing a summary of this feature, followed by another simple

visualization, a histogram, of this data. A boxplot is also a useful way to represent this feature because it

is a way of summarizing a set of data measured on an interval scale. It works by showing the shape of

the distribution, its central value, and its variability. From these two visualizations we find that the

maximum customer age is 70 while the minimum age is 18 years old.

Our third feature is that of the customers’ annual income which can be viewed using a basic

histogram. From these visualizations we can take away a few things; We can conclude that the minimum

annual income is 15,000 and the maximum income is 137,000. Customers who earn an average of

70,000 are the most frequent in our histogram depiction of the data. The average salary of all customers

is 60,560, which we found by running our summary() function on this variable. We can see this reflected

on both charts. Our density plot displays a Normal Distribution of our data. Normal distribution is a

symmetric distribution where the majority of our observations center around a peak, and the remaining

values taper off in either direction.

Finally, we can address our fourth variable which is the spending score of our customers. Again,

this is a score given to each customer based on their spending history, with a higher score suggesting

that the customer spends more than one with a lower score. This feature is already categorized for us in

a way, but if it had not already been, we would likely have wanted to “bin” this feature. By binning, we

would separate spending amounts into segments and then assign a score based on which level of

segment the customer fell into. To look at our spending score feature, we will first create a histogram of

the data as well as another box plot. We can see that the minimum Spending Score is 1 and the

maximum score is 99. From our summary we see that the average score is 50.20. We see all of these

values reflected in the visualizations. Looking at our histogram we can tell that the customers with

scores between 40 and 50 are the most frequent among all customers.

**K-means Algorithm**

Now that we have come to understand our variables and how they are situated within our data

set, we can move on to developing our K-means algorithm. K-means is a popular algorithm used for

clustering analysis because of its simplicity. This algorithm works iteratively to partition data points into

a predefined number of groups, or clusters, such that no point belongs to more than one group and

points within each cluster are the most similar to one another. It is commonly used for many

applications such as image segmentation, document clustering and, like in our case, customer

segmentation.

The first thing we want to do when creating a K-means algorithm is to indicate how many

clusters, k, we want in our final output. The algorithm then selects that defined number of objects at

random from our data set, which gives us our initial cluster centers, or centroids. These centroids serve

as the mean values for each of our clusters. Now, every other data point in the data set is assigned to a

cluster based on its nearest centroid. This step is called “cluster assignment”, and this closeness is

defined by the Euclidian Distance that is present between the object and each centroid. This

measurement is defined as the “measure of the true straight line distance between two points”

(Trevino, 2016).

Once the cluster assignment is complete, the algorithm calculates new means for each group

based on its components. Using these new mean values, the cluster assignment process begins again to

determine if there are points which need to be relocated based on closeness to the newfound mean of

another cluster. As soon as the clusters determined by one iteration are identical to the determinations

of the previous one, the process comes to an end.

When working with this type of algorithm, it is up to us to first determine the number of clusters

to be used. There are multiple methods for assisting us in making these determinations, three of which

we will examine next. These three methods are the elbow method, the silhouette method, and the gap

statistic method. Using the elbow method, we run the clustering on our dataset for a range of values, in

our case from 1 to 10, and then for each value of k, an average score for all clusters is computed. We

want to calculate the intra-cluster sum of squares, and then plot this based on the number of clusters. In

other words, we plot the value of the cost function produced by different values of k. On our plot, the

location of a bend is our indication of the optimal number of clusters. From the resulting plot we can

anticipate that the appropriate number of clusters is somewhere around 5 or 6, as this is where the

bend in the plot seems to appear.

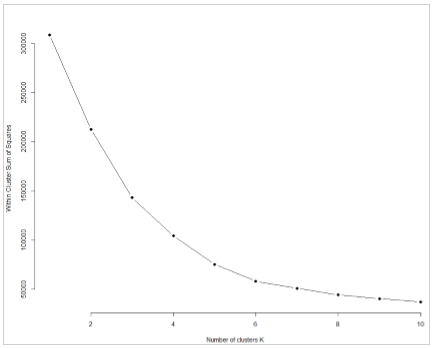


Figure 2: Elbow method plot

The average silhouette method is another option to help us make the determination of how

many clusters to use. A silhouette plot displays for us the measurement of closeness for each point in

one cluster to points in the neighboring cluster. This measurement has a range from -1 to +1, with coefficients close to 1 signaling that the point is far from neighboring clusters and that of 0 telling us

that the point is on or very close to the boundary of decision. A negative coefficient indicates that our

point may have been assigned to the incorrect cluster. Our optimal cluster will have the highest average

when we compute the average silhouette width. We will visualize silhouette plots for k values ranging

from 2 to 10, and then use a new function to visualize the optimal number of clusters (Figure 3). This

tells us that the optimal number of clusters to be used is six.

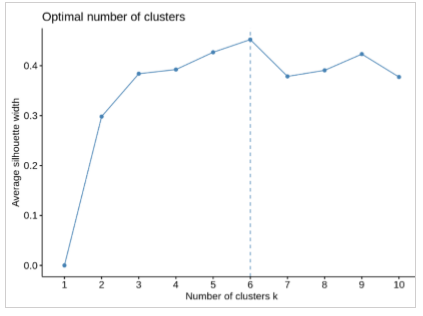


Figure 3: Silhouette method

The third method that we have at our disposal is called the gap statistic method. This method

has the flexibility to be applied to other clustering methods, such as hierarchical clustering, as well. This

method takes different k values and compares the total within intra-cluster variation with their expected

values under null reference distribution of the data. The optimal cluster number will be the value at

which the gap statistic is maximized. In other words, the clustering structure is far in distance from the

random uniform distribution of points. Once again, we are shown that 6 appears to be the optimal

number of clusters for our data.

Finally, using our suggested k values from the methods used above, we can implement our K

means algorithm for this data set. We run the kmeans() function which performs the algorithm on our

data matrix. The resulting table provides quite a bit of information. We are given the sizes of our 6

clusters, along with the means for each and the resulting clustering vector information which indicates

the cluster to which each point is allocated. The function also returns a list of components that can be

accessed. These components include cluster, centers, totss, withinss, tot.withinss, betweens, and size.

For example, if we run the call k6$betweens, we are given the sum of between-cluster squares; By

running k6$tot.withinss, we see the total intra-cluster sum of squares.

After running our kmeans() function we are ready to visualize the results. We will visualize the

segmentation based on our features Annual Income and Spending Score. We can clearly see our six

clusters and we are able to understand where each group falls in terms of classification based on these

two features. For example, cluster 3 represents those customers who have a low annual income as well

as a low spending score. These customers likely would not be the target customer for a business looking

at marketing strategy. On the other hand, cluster 5 with a high annual income and a low spending score

might be just the target for a company who wants to attempt to increase the spending habits of these

customers. When we visualize in another manner, using income level and age, we see clear groupings as

well, although not quite as clear-cut as with spending score. We can see that cluster 1 shares a similar

spending score but has a large age range, while clusters 3 and 5 maintain both a similar age and a similar

spending score.

**Summary**

K-means clustering has offered us the opportunity to analyze this data set with a business mind.

By clustering our consumers into segments, we are able to take an focused approach to marketing and

other business strategies to increase our reach and effectiveness. K-means has proven to be a valuable

method for use with this particular data set, which leads one to consider many other use cases where

this would be a valuable analysis, such as at a grocery or clothing store. By combining multiple methods

in assisting our initial cluster quantity decisions, we were able to make the most informed selection in

order to obtain a well-developed result. This is an important success for companies all over the world

and it is interesting to see how it progresses from step one to a complete analysis with a usable, real world outcome.

**Appendix**

R packages:

• plotrix

• ggplot2

• purrr

• cluster

• gridExtra

• NbClust

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