

TEN STEPS OF MARKET SEGMENTATION ANALYSIS

Step 1: Deciding (not) to Segment

3.1 Implications of Committing to Market Segmentation

- **Long-term Commitment:** Market segmentation requires a long-term commitment and substantial organizational changes, not just a one-time effort.
- **Costs Involved:** There are significant costs associated with research, surveys, design changes, and marketing communications. The strategy should only be pursued if the expected increase in sales justifies these costs.
- **Organizational Changes:** Implementing market segmentation may necessitate developing new products, modifying existing ones, changing pricing and distribution channels, and altering communication strategies.
- **Strategic Alignment:** To maximize benefits, organizations should align their structure around market segments rather than products, often requiring a shift to strategic business units focused on specific segments.
- **Executive Decision:** The decision to pursue market segmentation must be made at the highest executive level and be communicated and reinforced throughout the organization.

3.2 Implementation Barriers

- **Leadership and Resources:** Successful implementation requires active involvement and commitment from senior management, including adequate resource allocation.
- **Organizational Culture:** Resistance to change, lack of market orientation, and poor communication can impede the strategy. Creative thinking and a willingness to adopt new ideas are essential.
- **Training and Expertise:** Both senior management and the segmentation team need a solid understanding of market segmentation. Lack of training and expertise can hinder the process.
- **Formal Marketing Function:** The presence of a formal marketing function or qualified marketing experts is crucial, especially in large or diverse markets.
- **Objective Constraints:** Financial limitations or the inability to make necessary structural changes can also be significant barriers.
- **Process-Related Issues:** Clear objectives, proper planning, structured processes, and sufficient time are needed to overcome process-related barriers.

3.3 Step 1 Checklist

- **Assess Organizational Readiness:** Evaluate if the organization is market-oriented, willing to change, and open to new ideas. Good communication and the ability to make structural changes are also critical.
- **Financial Resources:** Ensure the organization has sufficient financial resources to support the strategy.
- **Senior Management Commitment:** Secure visible and active involvement from senior management, along with the necessary financial commitment.
- **Understanding and Training:** Ensure that both the concept and implications of market segmentation are fully understood, providing training if needed.
- **Segmentation Team:** Assemble a team with marketing, data, and data analysis experts, and set up an advisory committee representing all organizational units.
- **Clear Objectives and Process:** Define clear objectives, develop a structured process, assign responsibilities, and ensure ample time for the analysis.

Step 2: Specifying the Ideal Target Segment

4.1 Segment Evaluation Criteria

The third layer of market segmentation analysis heavily relies on user input, and this user involvement is necessary throughout the process. After committing to a segmentation strategy in Step 1, organizations must make significant conceptual contributions in Step 2. This involves determining two sets of segment evaluation criteria: knock-out criteria and attractiveness criteria.

Knock-out Criteria: These are essential, non-negotiable features that a segment must meet to be considered. If a segment does not meet these criteria, it is eliminated from further consideration.

Attractiveness Criteria: These criteria are used to evaluate the relative attractiveness of segments that meet the knock-out criteria. These criteria help in determining the most appealing segments for targeting.

Table 4.1 presents a variety of criteria proposed in the literature for evaluating market segments.

4.2 Knock-Out Criteria

Knock-out criteria are used to determine if market segments qualify for further assessment. Some key knock-out criteria include:

- **Homogeneity:** Segment members must be similar to one another.
- **Distinctiveness:** Segment members must be distinctly different from members of other segments.
- **Size:** The segment must be large enough to be worth targeting.
- **Match:** The segment must align with the organization's strengths and capabilities.
- **Identifiability:** It must be possible to identify members of the segment in the marketplace.
- **Reachability:** There must be a way to communicate and deliver the marketing mix to segment members.

These criteria need to be clearly understood and agreed upon by senior management, the segmentation team, and the advisory committee.

4.3 Attractiveness Criteria

Attractiveness criteria, unlike knock-out criteria, are used to rate how appealing a segment is. Segments are assessed on a scale of attractiveness rather than a binary compliance. The attractiveness criteria should be selected based on the organization's specific situation and needs.

4.4 Implementing a Structured Process

A structured approach to evaluating market segments is recommended, often using a segment evaluation plot. This plot shows segment attractiveness on one axis and organizational competitiveness on the other. Factors determining these values need to be negotiated and agreed upon, ideally by a team representing various organizational units.

Selecting attractiveness criteria early in the process ensures relevant data is collected and simplifies target segment selection in later steps. The segmentation team should agree on a set of about six attractiveness criteria, each with an assigned weight indicating its relative importance. The weightings should be discussed and agreed upon, with approval from the advisory committee.

4.5 Step 2 Checklist

To ensure a thorough and organized approach, follow this checklist:

Task	Responsible	Completed?
Convene a segmentation team meeting.		

Discuss and agree on knock-out criteria (homogeneity, distinctness, size, match, identifiability, reachability).		
Present knock-out criteria to the advisory committee for discussion and adjustment.		
Individually study available criteria for segment attractiveness assessment.		
Discuss and agree on a subset of no more than six attractiveness criteria with the segmentation team.		
Individually distribute 100 points across the agreed-upon attractiveness criteria to reflect their relative importance.		
Discuss weightings with the segmentation team and agree on final weightings.		
Present the selected criteria and proposed weights to the advisory committee for discussion and adjustment.		

Step 3: Collecting Data

5.1 Segmentation Variables

Empirical data forms the basis of both commonsense and data-driven market segmentation. It is used to identify or create market segments and describe these segments in detail. The term **segmentation variable** refers to the variable in the empirical data used in commonsense segmentation to split the sample into market segments. Typically, the segmentation variable is a single characteristic of the consumers in the sample.

In **commonsense segmentation**, each row in the data table represents one consumer, and each variable represents one characteristic of that consumer. An entry of 1 indicates the presence of that characteristic, while an entry of 0 indicates its absence. For example, using gender as the segmentation variable, market segments are created by splitting the sample into segments of women and men.

Other personal characteristics in the data, such as age, number of vacations taken, and information about benefits people seek when they go on vacation, serve as **descriptor variables**. These descriptor variables are used to describe the segments in detail, which is critical for developing an effective marketing mix targeting the segment.

In contrast, **data-driven market segmentation** is based on multiple segmentation variables, not just one. These variables serve as the starting point for identifying naturally existing or artificially created market segments useful to the organization. For example, tourists who share a common set of benefits they seek when going on vacation form a segment based on those benefits rather than gender or age.

These examples highlight the importance of high-quality empirical data for valid segmentation solutions. Good data ensures accurate segment assignment and description, which are essential for developing customized products, determining pricing strategies, selecting distribution channels, and choosing communication channels for advertising and promotion.

Empirical data for segmentation studies can come from various sources, including surveys, observations (e.g., scanner data), and experimental studies. Optimally, this data should reflect consumer behavior. Although survey data is common, it can be unreliable, especially when the behavior of interest is socially desirable. Therefore, exploring a range of data sources to find the one most reflective of actual consumer behavior is preferable.

5.2 Segmentation Criteria

Before extracting segments and collecting data, organizations must decide which **segmentation criterion** to use. The term segmentation criterion is broader than the term segmentation variable. It relates to the nature of the information used for market segmentation or one specific construct, such as benefits sought.

The decision on which segmentation criterion to use requires prior knowledge about the market and cannot easily be outsourced. Common segmentation criteria include geographic, socio-demographic, psychographic, and behavioral differences between consumers.

5.2.1 Geographic Segmentation

Geographic information is the original segmentation criterion, typically using the consumer's location of residence to form segments. This approach is simple and often appropriate. For example, a national tourism organization might target tourists from neighboring countries using different languages.

The key advantage of geographic segmentation is the ease of assigning each consumer to a geographic unit and targeting communication messages through local media channels. However, geographic segmentation has limitations as it does not necessarily reflect other relevant characteristics, such as benefits sought when purchasing a product. Despite these shortcomings, geographic segmentation is experiencing a revival in international market segmentation studies.

5.2.2 Socio-Demographic Segmentation

Typical socio-demographic segmentation criteria include age, gender, income, and education. These segments can be very useful in certain industries, such as luxury goods, cosmetics, baby products, retirement villages, and tourism resort products.

The advantage of socio-demographic segmentation is the ease of determining segment membership. Sometimes, socio-demographic criteria explain specific product preferences. However, in many cases, these criteria do not provide sufficient market insight for optimal segmentation decisions. Estimates suggest that demographics explain about 5% of the variance in consumer behavior, and socio-demographics may not be the strongest basis for market segmentation.

5.2.3 Psychographic Segmentation

Psychographic segmentation groups people based on psychological criteria, such as beliefs, interests, preferences, aspirations, or benefits sought. This approach is more complex than geographic or socio-demographic segmentation because it often requires multiple segmentation variables.

Psychographic segmentation is generally more reflective of the underlying reasons for differences in consumer behavior. However, it increases the complexity of determining segment memberships and relies heavily on the reliability and validity of the empirical measures used.

5.2.4 Behavioral Segmentation

Behavioral segmentation focuses on similarities in behavior or reported behavior, such as prior experience with the product, purchase frequency, amount spent, and information search behavior. This approach is advantageous because it uses the behavior of interest as the basis for segment extraction.

Behavioral segmentation groups people by the most relevant similarity, avoiding the need for valid measures for psychological constructs. However, behavioral data is not always readily available, especially if the aim is to include potential customers who have not previously purchased the product.

5.3 Data from Survey Studies

Most market segmentation analyses are based on survey data, which is cheap and easy to collect. However, survey data can be contaminated by various biases that negatively affect the quality of market segmentation analysis. Key considerations when using survey data include:

5.3.1 Choice of Variables

Selecting appropriate variables for segmentation is crucial. All relevant variables must be included while avoiding unnecessary ones. Unnecessary variables can cause respondent fatigue, lower response quality, and increase the dimensionality of the segmentation problem without adding valuable information. Such variables, known as noisy or masking variables, can prevent algorithms from identifying the correct segmentation solution.

To avoid these issues, it's recommended to:

- Ask necessary and unique questions.
- Avoid redundant questions.
- Conduct exploratory or qualitative research to develop a robust questionnaire.

5.3.2 Response Options

The type of response options provided in surveys impacts the scale of data and subsequent analyses. Different types of data include:

- **Binary/Dichotomous Data:** Represented by 0s and 1s, suitable for segmentation analysis.
- **Nominal Data:** Categories without order, can be transformed into binary data.
- **Metric Data:** Allows statistical procedures and distance measurement, ideal for segmentation.
- **Ordinal Data:** Ordered categories without clear distances, challenging for distance-based analyses.

For optimal segmentation analysis, binary or metric response options are preferable. Visual analogue scales, often used in online surveys, can capture nuanced responses and generate metric data.

5.3.3 Response Styles

Response biases, such as tendencies to use extreme options or agree with all statements, can distort segmentation results. These biases, or response styles, affect algorithms' ability to identify true market segments. To mitigate this, additional analyses or removal of biased respondents might be necessary.

5.3.4 Sample Size

Sample size significantly impacts the ability of segmentation algorithms to identify correct segments. Recommendations for sample size vary:

- Formann (1984): At least $2p^2$ (better five times $2p^2$), where p is the number of variables.
- Qiu and Joe (2015): At least $10 \times p \times k$, where k is the number of segments.
- Dolnicar et al. (2014): At least $60 \times p$ or $70 \times p$ for more complex scenarios.

Challenges like correlated variables and noisy data require larger samples. Optimal survey data for segmentation should:

- Include necessary items.
- Exclude unnecessary and correlated items.
- Be high quality, binary or metric.
- Be free of response styles.

- Have a sample size of at least 100 respondents per segmentation variable.

5.4 Data from Internal Sources

Organizations increasingly use internal data, such as scanner data, booking data, and online purchase data, for market segmentation. This data reflects actual consumer behavior and is often automatically generated, requiring no extra collection effort. However, internal data may be biased by over-representing existing customers and missing information about potential new customers.

5.5 Data from Experimental Studies

Experimental data can provide valuable insights for market segmentation analysis. Here are some key points about using experimental data:

Types of Experimental Data

1. **Advertisement Response:** Field or laboratory experiments can test how people respond to different advertisements. The response to these ads can serve as a segmentation criterion, indicating preferences or behaviors related to specific marketing stimuli.
2. **Conjoint Analysis and Choice Experiments:** These studies present consumers with scenarios involving different combinations of product attributes. Consumers then choose their preferred option, revealing preferences for specific attributes and attribute levels. This data can be used directly as segmentation criteria based on consumer preferences.

Applications in Segmentation Analysis

- **Segmentation Criterion:** Experimental results, such as preferences for certain product attributes or responses to ads, can directly define market segments.
- **Attribute Importance:** Information from conjoint analysis or choice experiments can quantify the importance of different product attributes in consumer decision-making. These attributes can then serve as segmentation variables.

Advantages of Experimental Data

- **Controlled Environment:** Experiments allow for precise control over variables, reducing external influences and biases compared to survey data.
- **Direct Insights:** Experimental results directly measure consumer responses or preferences, providing clear segmentation criteria without reliance on self-reported data.

Considerations

- **Data Collection:** Ensure experimental design captures relevant consumer behaviors or preferences that align with segmentation goals.
- **Validity and Reliability:** Carefully design experiments to minimize biases and ensure results accurately reflect consumer preferences or behaviors.

5.6 Step 3 Checklist

Task Checklist

Task	Responsible	Completed?
Convene a market segmentation team meeting.	Team Leader	<input type="checkbox"/>
Discuss promising segmentation variables based on consumer characteristics.	Team	<input type="checkbox"/>

Identify additional consumer characteristics needed to understand market segments.	Team	<input type="checkbox"/>
Plan data collection methods to capture segmentation and descriptor variables validly.	Data Analyst	<input type="checkbox"/>
Design data collection protocols to minimize biases and systematic errors.	Data Analyst	<input type="checkbox"/>
Collect data according to the designed protocols.	Data Collection Team	<input type="checkbox"/>

Step 8: Selecting (the) Target Segment(s)

10.1 The Targeting Decision

In market segmentation analysis, Step 8 marks the critical decision of selecting one or more market segments to target. Here's a breakdown of the process and considerations involved:

Importance of Targeting Decision

- **Strategic Impact:** Selecting target segments is a long-term decision that significantly influences organizational performance.
- **Criteria Alignment:** After Steps 5 and 6, where segments are identified and profiled, and their attractiveness evaluated, Step 8 ensures that remaining segments align with previously set knock-out criteria (homogeneity, size, distinctness, etc.).

Evaluation Process

1. **Knock-out Criteria Review:** Ensure all remaining segments meet the agreed-upon knock-out criteria from earlier steps to eliminate any unsuitable segments.
2. **Segment Attractiveness:** Evaluate the attractiveness of each segment based on criteria such as market size, growth potential, profitability, and strategic fit with organizational goals.
3. **Organizational Competitiveness:** Assess how well the organization can serve each segment compared to competitors. This includes factors like product fit, pricing, distribution channels, and brand perception.

Decision Tools: Market Segment Evaluation

- **Decision Matrix:** Utilize a matrix (e.g., Boston Matrix, GE/McKinsey Matrix) to visually compare segment attractiveness against organizational competitiveness. This helps in objectively assessing which segments to prioritize.
- **Plotting Segment Evaluation:** Plot segments based on their attractiveness to the organization (x-axis) and the organization's attractiveness to the segment (y-axis). Bubble sizes can represent additional criteria like profitability or loyalty potential.

Final Steps

- **Compatibility Check:** Ensure selected segments are compatible with each other and with the organization's capabilities and resources.
- **Committee Approval:** Present the chosen segments to an advisory committee for feedback and final approval, if required.

Step 9: Customizing the Marketing Mix

This step discusses various aspects of market segmentation and its integration with the marketing mix, particularly focusing on product, price, place, and promotion (4Ps). It emphasizes that market segmentation should not be viewed in isolation but rather as part of a broader strategic approach that includes targeting and positioning.

Here are some key points related to each element of the marketing mix:

1. **Product:** Tailoring products to meet the specific needs and preferences of target segments, possibly by developing new products or modifying existing ones to align with segment characteristics.
2. **Price:** Setting prices based on segment-specific insights, such as willingness to pay or spending patterns, to maximize revenue without necessarily needing to offer discounts for highly targeted products.
3. **Place (Distribution):** Choosing distribution channels that align with how target segments prefer to make purchases, such as online platforms or specific retail outlets that cater to their booking or buying behaviors.
4. **Promotion:** Designing promotional strategies that resonate with the communication preferences of target segments, utilizing channels like tourist information centers or specific TV channels preferred by the segment.

Each of these elements underscores the importance of understanding and adapting the marketing mix to effectively reach and serve distinct market segments, ensuring alignment with broader strategic goals like differentiation and competitive positioning.

Step 10: Evaluation and Monitoring

Ongoing Tasks in Market Segmentation

1. **Evaluation of Segmentation Strategy Effectiveness:**
 - After implementing a segmentation strategy, it's crucial to evaluate its effectiveness continuously.
 - This evaluation assesses whether the strategy has increased profits or achieved organizational goals.
 - If the strategy fails to deliver the expected outcomes, adjustments may be necessary to avoid financial losses or missed opportunities.
2. **Monitoring Market Dynamics:**
 - Markets are dynamic; consumer behaviors, competitive actions, and environmental factors constantly evolve.
 - Therefore, continuous monitoring of the segmentation strategy is essential.
 - This monitoring can range from regular reviews by a segmentation team to automated systems using data mining to detect changes in the size or characteristics of the target segments.

Evaluating the Success of Segmentation Strategy

- **Short-term Goals:** Typically focus on profitability or achieving specific organizational missions. For non-profit organizations, success metrics may include donations raised or volunteer recruitment.
- **Long-term Goals:** Assess the effectiveness of targeted positioning. This involves tracking how well the organization is perceived in the market. A successful strategy should enhance the organization's reputation and competitive advantage in meeting specific consumer needs.

Stability of Segment Membership and Segment Hopping

- **Segment Membership Stability:** Research indicates that consumer segment memberships are often unstable over time.
- **Segment Hopping:** Refers to consumers switching between segments based on varying needs or situations.
- **Implications:** Understanding segment hopping is crucial for segmentation strategies. It requires strategies that can accommodate or predict such behavior to maintain effective targeting and marketing efforts.

Segment Evolution

- **Reasons for Segment Evolution:** Changes in consumer behavior, product innovations, and competitive actions drive segment evolution.
- **Monitoring and Adapting:** Continuous tracking of segment characteristics and behaviors is necessary to adapt marketing strategies effectively.
- **Methodologies:** Various analytical frameworks, like MONIC and Markov chains, are used to model segment evolution over time using longitudinal data.

Example: Winter Vacation Activities

- **Data Analysis:** Demonstrates how market segments for winter vacation activities in Austria evolved between 1991/92 and 1997/98.
- **Segment Profiles:** Show how different segments engaged in various winter activities and how these preferences changed over time.
- **Implications for Tourism Organizations:** Changes in segment sizes and preferences highlight the need for tourism organizations to adapt their offerings to meet evolving consumer preferences.

Key Takeaways

- **Continuous Process:** Market segmentation is not a one-time activity but an ongoing strategic process.
- **Adaptability:** Strategies must be adaptable to accommodate changing market dynamics and consumer behaviors.
- **Data-Driven:** Effective segmentation strategies rely heavily on data analytics and continuous monitoring to remain relevant and effective over time.

CODE LINK – [McDonalds Case Study](#)

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