Identifying Market Segments and Selecting Target Markets

We will address the following questions:

- How and why is segmentation applied to consumer and business markets?
- How can a company use mass customization to effectively meet the needs of individual customers?
- What targeting strategies can a company use to select and enter the most attractive market segments?

A company cannot serve everyone in broad markets such as soft drinks (for consumers) and computers (for businesses), because the customers are too numerous and diverse in their buying requirements. This is why successful marketers look for specific market segments that they can serve more effectively. Instead of scattering their marketing efforts (a "shotgun" approach), they will be able to focus on the buyers whom they have the greatest chance of satisfying (a "rifle" approach).

The most targeted marketing strategies are built around meeting each customer's unique requirements. Such mass customization strategies are particularly well suited to Internet marketing, where leaders such as Dell can maintain an interactive dialogue with customers and create a unique bundle of goods and services specifically for their individual needs and wants.

Target marketing requires marketers to take three major steps: (1) Identify and profile distinct groups of buyers who might require separate products or marketing mixes (market segmentation); (2) select one or more market segments to enter (market targeting); and (3) establish and communicate the products' key distinctive benefits in the market (market positioning). This chapter focuses on the first two steps; the following chapter will discuss positioning strategy.

USING MARKET SEGMENTATION

Market segmentation aims to increase a company's precision marketing. In contrast, sellers that use *mass marketing* engage in the mass production, distribution, and promotion of one product for all buyers. Henry Ford epitomized this strategy when he offered the Model T Ford "in any color, as long as it is black." Coca-Cola also used mass marketing when it sold only one kind of Coke in a 6.5-ounce bottle.

The argument for mass marketing is that it creates the largest potential market, which leads to the lowest costs, which in turn can lead to lower prices or higher margins. However, many critics point to the increasing splintering of the market, which makes mass marketing more difficult. According to Regis McKenna, "[Consumers] have more ways to shop: at giant malls, specialty shops, and superstores; through mail-order catalogs, home shopping networks, and virtual stores on the Internet. And they are bombarded with messages pitched through a growing number of channels: broadcast and narrow-cast television, radio, on-line computer networks, the Internet, telephone services such as fax and telemarketing, and niche magazines and other print media."[1]

This proliferation of media and distribution channels is making it difficult to practice "one size fits all" marketing. Some observers even claim that mass marketing is dying. Therefore, to stay focused rather than scattering their marketing resources, more marketers are using market segmentation. In this approach, which falls midway between mass marketing and individual marketing, each segment's buyers are assumed to be quite similar in wants and needs, yet no two buyers are really alike. To use this technique, a company must understand both the levels and the patterns of market segmentation.

Levels of Market Segmentation

Regardless of whether they serve the consumer market or the business market—offering either goods or services—companies can apply segmentation at one of four levels: segments, niches, local areas, and individuals.

Segment Marketing

A *market segment* consists of a large identifiable group within a market, with similar wants, purchasing power, geographical location, buying attitudes, or buying habits. For example, an automaker may identify four broad segments in the car market: buyers who are primarily seeking (1) basic transportation, (2) high performance, (3) luxury, or (4) safety.

Because the needs, preferences, and behavior of segment members are similar but not identical, Anderson and Narus urge marketers to present *flexible market offerings* instead of one standard offering to all members of a segment.[2] A flexible market offering consists of the product and service elements that all segment members value, plus options (for an additional charge) that some segment members value. For example, Delta Airlines offers all economy passengers a seat, food, and soft drinks, but it charges extra for alcoholic beverages and earphones.

Segment marketing allows a firm to create a more fine-tuned product or service offering and price it appropriately for the target audience. The choice of distribution channels and communications channels becomes much easier, and the firm may find it faces fewer competitors in certain segments.

Niche Marketing

A *niche* is a more narrowly defined group, typically a small market whose needs are not being well served. Marketers usually identify niches by dividing a segment into subseg-

ments or by defining a group seeking a distinctive mix of benefits. For example, a tobacco company might identify two subsegments of heavy smokers: those who are trying to stop smoking, and those who don't care.

In an attractive niche, customers have a distinct set of needs; they will pay a premium to the firm that best satisfies their needs; the niche is not likely to attract other competitors; the nicher gains certain economies through specialization; and the niche has size, profit, and growth potential. Whereas segments are fairly large and normally attract several competitors, niches are fairly small and may attract only one or two rivals. Still, giants such as IBM can and do lose pieces of their market to nichers: Dalgic labeled this confrontation "guerrillas against gorillas."[3]

Some larger firms have therefore turned to niche marketing. Ramada Franchises Enterprises, for example, offers lodgings in several niches: Ramada Limited for economy travelers; Ramada Inn as a mid-price, full-service hotel; Ramada Plaza for the upper-mid-price niche; Ramada Hotels for good quality, three-star service; and Ramada Renaissance hotels, offering excellent, four-star service. Many German mid-size companies are also profiting through smart niching: Tetra Food supplies 80 percent of the food for tropical fish; Hohner holds 85 percent of the world harmonica market; and Becher has 50 percent of the world's oversized umbrella market. These firms are succeeding in their chosen niches because they are dedicated to their customers, offer superior service, and innovate continuously.[4]

Now the low cost of marketing on the Internet is making it more profitable for firms—including small businesses—to serve even seemingly minuscule niches. In fact, 15 percent of all commercial Web sites with fewer than 10 employees take in more than $100,000, and 2 percent ring up more than $1 million. The recipe for Internet niching success: Choose a hard-to-find product that customers don't need to see and touch. Consider Steve Warrington's successful on-line venture selling ostriches and every product derived from them (www.ostrichesonline.com). Launched for next to nothing on the Web, Warrington's business generates annual sales of $4 million-plus. Visitors to the site can buy ostrich meat, feathers, leather jackets, videos, eggshells, and skin-care products derived from ostrich body oil.[5]

Local Marketing

Target marketing is leading to some marketing programs that are tailored to the needs and wants of local customer groups (trading areas, neighborhoods, even individual stores). Citibank, for instance, adjusts its banking services in each branch depending on neighborhood demographics; Kraft helps supermarket chains identify the cheese assortment and shelf positioning that will optimize cheese sales in low-, middle-, and high-income stores and in different ethnic neighborhoods.

Those favoring local marketing see national advertising as wasteful because it fails to address local needs. On the other hand, opponents argue that local marketing drives up manufacturing and marketing costs by reducing economies of scale. Moreover, logistical problems become magnified when companies try to meet varying local requirements, and a brand's overall image might be diluted if the product and message differ in different localities.

Individual Marketing

The ultimate level of segmentation leads to "segments of one," "customized marketing," or "one-to-one marketing."[6] For centuries, consumers were served as individuals: The tailor made the suit and the cobbler designed shoes for the individual. Much business-to-business marketing today is customized, in that a manufacturer will customize the offer, logistics, communications, and financial terms for each major account. Now

technologies such as computers, databases, robotic production, intranets and extranets, e-mail, and fax communication are permitting companies to return to customized marketing, also called "mass customization."[7] *Mass customization* is the ability to prepare individually designed products and communications on a mass basis to meet each customer's requirements.

For example, Andersen Windows, a $1 billion Minnesota-based manufacturer of residential windows, turned to mass customization after additions to its product line led to fat, unwieldy catalogs and a bewildering array of choices for homeowners and contractors. Then the firm equipped 650 showrooms with an interactive computer catalog linked directly to the factory. Using this catalog, salespeople help customers customize each window, check the design for structural soundness, and generate a price quote. Andersen has also developed a "batch of one" manufacturing process in which everything is made to order, thus reducing its finished parts inventory (a major cost to the company).[8]

Joseph Pine, author of *Mass Customization,* says, "Anything you can digitize, you can customize." In fact, the Internet is bringing mass customization to an astonishing array of products. Mattel's Barbie.com site invites girls to log on and design their own Barbie Pal doll by specifying skin tone, eye color, hairdo and hair color, clothes, accessories, and name. CDuctive, a hip, New York-based company, lets customers cut their own CDs online. If a customer likes acid jazz, he can click on the category, see the various titles, listen to a brief sample of each, and then click to order a CD with his chosen tunes.[9] Technology like this is transforming marketing from "a broadcast medium to a dialog medium," allowing the customer to actively participate in the design of the product and offer.

Although individual customers are taking more initiative in designing and buying products, marketers still need to influence the process in a variety of ways. They need toll-free phone numbers and e-mail addresses to enable buyers to reach them with questions, suggestions, and complaints; they must involve customers more in the product-specification process; and they need a Web site with complete, updated information about the company's products, service guarantees, and locations.

Patterns of Market Segmentation

Market segments can be built up in many ways. One common method is to identify *preference segments.* Suppose ice cream buyers are asked how much they value sweetness and creaminess as two product attributes. Three different patterns can emerge:

➤ *Homogeneous preferences:* Figure 3-6 shows a market in which all of the consumers have roughly the same preference, so there are no natural segments. We predict that existing brands would be similar and cluster around the middle of the scale in both sweetness and creaminess.

➤ *Diffused preferences:* At the other extreme, consumer preferences may be scattered throughout the space (Figure 3-6), indicating great variance in consumer preferences. One brand might position in the center to appeal to the most people; if several brands are in the market, they are likely to position throughout the space and show real differences to reflect consumer-preference differences.

➤ *Clustered preferences:* The market might reveal distinct preference clusters, called *natural market segments* (Figure 3-6). The first firm in this market might position in the center to appeal to all groups, choose the largest market segment (*concentrated marketing*), or develop several brands for different segments. If the first firm has only one brand, competitors would enter and introduce brands in the other segments.

Smart marketers examine such segmentation patterns carefully to better understand the various positions they might take in a market—and the competitive implications.
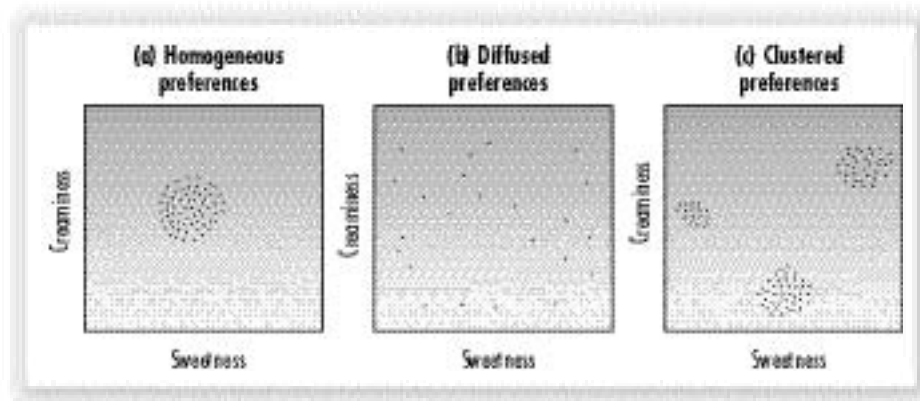
Figure 3-6   Basic Market-Preference Patterns

Market-Segmentation Procedure

Marketers use a three-step procedure for identifying market segments:

1. *Survey stage.* The researcher conducts exploratory interviews and focus groups to gain insight into customer motivations, attitudes, and behavior. Then the researcher prepares a questionnaire and collects data on attributes and their importance ratings, brand awareness and brand ratings, product-usage patterns, attitudes toward the product category, and respondents' demographics, geographics, psychographics, and mediagraphics.

2. *Analysis stage.* The researcher applies *factor analysis* to the data to remove highly correlated variables, then applies *cluster analysis* to create a specified number of maximally different segments.

3. *Profiling stage.* Each cluster is profiled in terms of its distinguishing attitudes, behavior, demographics, psychographics, and media patterns, then each segment is given a name based on its dominant characteristic. In a study of the leisure market, Andreasen and Belk found six segments:[10] passive homebody, active sports enthusiast, inner-directed self-sufficient, culture patron, active homebody, and socially active. They found that performing arts organizations could sell the most tickets by targeting culture patrons as well as socially active people.

Companies can uncover new segments by researching the hierarchy of attributes that customers consider when choosing a brand. For instance, car buyers who first decide on price are price dominant; those who first decide on car type (e.g., passenger, sport-utility) are type dominant; those who first decide on brand are brand dominant. With these segments, customers may have distinct demographics, psychographics, and mediagraphics to be analyzed and addressed through marketing programs.[11]

SEGMENTING CONSUMER AND BUSINESS MARKETS

Because of the inherent differences between consumer and business markets, marketers cannot use exactly the same variables to segment both. Instead, they use one broad group of variables as the basis for consumer segmentation and another broad group for business segmentation.

Bases for Segmenting Consumer Markets

In segmenting consumer markets, marketers can apply geographic, demographic, and psychographic variables related to *consumer characteristics* as well as behavioral variables related to *consumer responses* (see Table 3.5). Once the segments are formed, the marketer sees whether different characteristics are associated with each consumer-response segment. For example, the researcher might examine whether car buyers who want "quality" versus "low price" differ in their geographic, demographic, and psychographic makeup. This will determine whether the segments are useful for marketing purposes.

Geographic Segmentation

Geographic segmentation calls for dividing the market into different geographical units such as nations, states, regions, counties, cities, or neighborhoods. The company can operate in one or a few geographic areas or operate in all but pay attention to local variations. Some marketers even segment down to a specific zip code. Consider Blockbuster, which has databases to track the video preferences of its 85 million members and buys additional demographic data about each store's local area. As a result of this segmentation, it stocks its San Francisco stores with more gay-oriented videos, reflecting the city's large gay population, while it stocks Chicago stores with more family-oriented videos. Blockbuster can even distinguish between patterns of East Dallas and South Dallas customers.[12]

Demographic Segmentation

In *demographic segmentation,* the market is divided into groups on the basis of age and the other variables in Table 3.5. One reason this is the most popular consumer segmentation method is that consumer wants, preferences, and usage rates are often associated with demographic variables. Another reason is that demographic variables are easier to measure. Even when the target market is described in nondemographic terms (say, a personality type), the link back to demographic characteristics is needed in order to estimate the size of the target market and the media that should be used to reach it efficiently.

Here is how certain demographic variables have been used to segment consumer markets:

➤ *Age and life-cycle stage.* Consumer wants and abilities change with age, as Gerber realized when it decided to expand beyond its traditional baby foods line because the market was growing more slowly due to lower birthrates, babies staying on formula longer, and children moving to solid foods sooner. The company hopes that parents who buy its baby food will go on to buy its Graduates foods for 1- to 3-year olds.[13] However, age and life cycle can be tricky variables. For example, Ford originally designed its Mustang automobile to appeal to young people who wanted an inexpensive sport car. But when Ford found that the car was being purchased by all age groups, it recognized that the target market was not the chronologically young, but the psychologically young.

➤ *Gender.* Gender segmentation has long been applied in clothing, hairstyling, cosmetics, and magazines. Occasionally other marketers notice an opportunity for gender segmentation. The Internet portal iVillage.com reaped the benefits of gender segmentation after initially trying to appeal to a broader market of baby boomers. Noticing that Parent Soup and other offerings for women were the most popular, iVillage soon evolved into the leading women's on-line community. Its home page entreats visitors to "Join our community of smart, compassionate, real women."[14]

Table 3.5 Major Segmentation Variables for Consumer Markets

Geographic

Region	Pacific, Mountain, West North Central, West South Central, East North Central, East South Central, South Atlantic, Middle Atlantic, New England
City or metro size	Under 4,999; 5,000–19,999; 20,000–49,999; 50,000–99,999; 100,000–249,999; 250,000–499,999; 500,000–999,999; 1,000,000–3,999,999; 4,000,000 or over
Density	Urban, suburban, rural
Climate	Northern, southern

Demographic

Age	Under 6, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
Family Size	1–2, 3–4, 5+
Family life cycle	Young, single; young, married, no children; young, married, youngest child under 6; young, married, youngest child 6 or over; older, married, with children; older, married, no children under 18; older, single; other
Gender	Male, female
Income	Under $9,999; $10,000–$14,999; $15,000–$19,999; $20,000–$29,999; $30,000–$49,999; $50,000–$99,999; $100,000 and over
Occupation	Professional and technical; managers, officials, and proprietors; clerical, sales; craftspeople; forepersons; operatives; farmers; retired; students; homemakers; unemployed
Education	Grade school or less; some high school; high school graduate; some college; college graduate
Religion	Catholic, Protestant, Jewish, Muslim, Hindu, other
Race	White, Black, Asian, Hispanic
Generation	Baby boomers, Generation Xers
Nationality	North American, South American, British, French, German, Italian, Japanese
Social class	Lower lowers, upper lowers, working class, middle class, upper middles, lower uppers, upper uppers

Psychographic

Lifestyle	Straights, swingers, longhairs
Personality	Compulsive, gregarious, authoritarian, ambitious

Behavioral

Occasions	Regular occasion, special occasion
Benefits	Quality, service, economy, speed
User status	Nonuser, ex-user, potential user, first-time user, regular user
Usage rate	Light user, medium user, heavy user
Loyalty status	None, medium, strong, absolute
Readiness stage	Unaware, aware, informed, interested, desirous, intending to buy
Attitude toward product	Enthusiastic, positive, indifferent, negative, hostile

➤ *Income.* Income segmentation is a long-standing practice in such categories as automobiles, boats, clothing, cosmetics, and travel. However, income does not always predict the best customers for a given product. The most economical cars are not bought by the really poor, but rather by those who think of themselves as poor relative to their status aspirations; medium-price and expensive cars tend to be purchased by the overprivileged segments of each social class.

➤ *Generation.* Each generation is profoundly influenced by the times in which it grows up—the music, movies, politics, and events of that period. Some marketers target Generation Xers (those born between 1964 and 1984), while others target Baby Boomers (those born between 1946 and 1964).[15] Meredith and Schewe have proposed a more focused concept they call cohort segmentation.[16] *Cohorts* are groups of people who share experiences of major external events (such as World War II) that have deeply affected their attitudes and preferences. Because members of a cohort group feel a bond with each other for having shared these experiences, effective marketing appeals use the icons and images that are prominent in the targeted cohort group's experience.

➤ *Social class.* Social class strongly influences preference in cars, clothing, home furnishings, leisure activities, reading habits, and retailers, which is why many firms design products for specific social classes. However, the tastes of social classes can change over time. The 1980s were about greed and ostentation for the upper classes, but the 1990s were more about values and self-fulfillment. Affluent tastes now run toward more utilitarian rather than ostentatious products.[17]

Psychographic Segmentation

In *psychographic segmentation,* buyers are divided into different groups on the basis of lifestyle or personality and values. People within the same demographic group can exhibit very different psychographic profiles.

➤ *Lifestyle.* People exhibit many more lifestyles than are suggested by the seven social classes, and the goods they consume express their lifestyles. Meat seems an unlikely product for lifestyle segmentation, but one Kroger supermarket in Nashville found that segmenting self-service meat products by lifestyle, not by type of meat, had a big payoff. This store grouped meats by lifestyle, creating such sections as "Meals in Minutes" and "Kids Love This Stuff" (hot dogs, hamburger patties, and the like). By focusing on lifestyle needs, not protein categories, Kroger's encouraged habitual beef and pork buyers to consider lamb and veal as well—boosting sales and profits.[18] But lifestyle segmentation does not always work: Nestlé introduced a special brand of decaffeinated coffee for "late nighters," and it failed, presumably because people saw no need for such a specialized product.

➤ *Personality.* Marketers can endow their products with *brand personalities* that correspond to consumer personalities. Apple Computer's iMac computers, for example, have a friendly, stylish personality that appeals to buyers who do not want boring, ordinary personal computers.[19]

➤ *Values.* Core values are the belief systems that underlie consumer attitudes and behaviors. Core values go much deeper than behavior or attitude, and determine, at a basic level, people's choices and desires over the long term. Marketers who use this segmentation variable believe that by appealing to people's inner selves, it is possible to influence purchase behavior. Although values often differ from culture to culture, Roper Reports has identified six values segments stretching across 35 countries: strivers (who focus more on material and professional goals), devouts

(who consider tradition and duty very important), altruists (who are interested in social issues), intimates (who value close personal relationships and family highly), fun seekers (who tend to be younger and usually male), and creatives (who are interested in education, knowledge, and technology).[20]

Behavioral Segmentation

In *behavioral segmentation,* buyers are divided into groups on the basis of their knowledge of, attitude toward, use of, or response to a product. Many marketers believe that behavioral variables—occasions, benefits, user status, usage rate, loyalty status, buyer-readiness stage, and attitude—are the best starting points for constructing market segments.

➤ *Occasions.* Buyers can be distinguished according to the occasions on which they develop a need, purchase a product, or use a product. For example, air travel is triggered by occasions related to business, vacation, or family, so an airline can specialize in one of these occasions. Thus, charter airlines serve groups of people who fly to a vacation destination. Occasion segmentation can help firms expand product usage, as the Curtis Candy Company did when it promoted trick-or-treating at Halloween and urged consumers to buy candy for the eager little callers. A company can also consider critical life events to see whether they are accompanied by certain needs. This kind of analysis has led to service providers such as marriage, employment, and bereavement counselors.

➤ *Benefits.* Buyers can be classified according to the benefits they seek. One study of travelers uncovered three benefit segments: those who travel to be with family, those who travel for adventure or education, and those who enjoy the "gambling" and "fun" aspects of travel.[21]

➤ *User status.* Markets can be segmented into nonusers, ex-users, potential users, first-time users, and regular users of a product. The company's market position also influences its focus. Market leaders (such as America Online) focus on attracting potential users, whereas smaller firms (such as Earthlink, a fast-growing Internet service provider) try to lure users away from the leader.

➤ *Usage rate.* Markets can be segmented into light, medium, and heavy product users. Heavy users are often a small percentage of the market but account for a high percentage of total consumption. Marketers usually prefer to attract one heavy user rather than several light users, and they vary their promotional efforts accordingly. Repp's Big & Tall Stores, which operates 200 stores and a catalog business, has identified 12 segments by analyzing customer response rates, average sales, and so on. Some segments get up to eight mailings a year, while some get only one to three mailings. The chain tries to steer low-volume catalog shoppers into nearby stores, and it offers infrequent customers an incentive such as 15 percent off to buy during a particular period. Repp gets a 6 percent response to these segmented mailings, far more than the typical 0.5 response rate for nonsegmented mailings.[22]

➤ *Loyalty status.* Buyers can be divided into four groups according to brand loyalty status: (1) hard-core loyals (who always buy one brand), (2) split loyals (who are loyal to two or three brands), (3) shifting loyals (who shift from one brand to another, and (4) switchers (who show no loyalty to any brand).[23] Each market consists of different numbers of these four types of buyers; thus, a *brand-loyal market* has a high percentage of hard-core loyals. Companies that sell in such a market have a hard time gaining more market share, and new competitors have a hard time breaking in. One caution: What appears to be brand loyalty may actually reflect habit, indifference, a low price, a high switching cost, or the nonavailability of other

brands. For this reason, marketers must carefully interpret what is behind observed purchasing patterns.

➤ *Buyer-readiness stage.* A market consists of people in different stages of readiness to buy a product: Some are unaware of the product, some are aware, some are informed, some are interested, some desire the product, and some intend to buy. The relative numbers make a big difference in designing the marketing program.

➤ *Attitude.* Five attitude groups can be found in a market: (1) enthusiastic, (2) positive, (3) indifferent, (4) negative, and (5) hostile. So, for example, workers in a political campaign use the voter's attitude to determine how much time to spend with that voter. They may thank enthusiastic voters and remind them to vote, reinforce those who are positively disposed, try to win the votes of indifferent voters, and spend no time trying to change the attitudes of negative and hostile voters.

Multi-Attribute Segmentation (Geoclustering)

Marketers are increasingly combining several variables in an effort to identify smaller, better defined target groups. Thus, a bank may not only identify a group of wealthy retired adults, but within that group may distinguish several segments depending on current income, assets, savings, and risk preferences.

One of the most promising developments in multi-attribute segmentation is *geoclustering,* which yields richer descriptions of consumers and neighborhoods than does traditional demographics. Geoclustering can help a firm answer such questions as: Which clusters (neighborhoods or zip codes) contain our most valuable customers? How deeply have we already penetrated these segments? Which markets provide the best opportunities for growth?

Claritas Inc. has developed a geoclustering approach called PRIZM (Potential Rating Index by Zip Markets), classifying over half a million U.S. residential neighborhoods into 62 lifestyle groupings called PRIZM Clusters.[24] The groupings take into consideration 39 factors in five broad categories: (1) education and affluence, (2) family life cycle, (3) urbanization, (4) race and ethnicity, and (5) mobility, and cover specific geographic areas defined by Zip code, Zip + 4, census tract, and block group.

Each cluster has a descriptive title, such as *American Dreams* and *Rural Industria.* Within each cluster, members tend to lead similar lives, drive similar cars, have similar jobs, and read similar magazines. The American Dreams cluster, for example, is upscale and ethnic—a big-city mosaic of people likely to buy imported cars, *Elle* magazine, Mueslix cereal, tennis weekends, and designer jeans. In contrast, Rural Industria contains young families in heartland offices and factories whose lifestyle is typified by trucks, *True Story* magazine, Shake n' Bake, fishing trips, and tropical fish.[25]

Geoclustering is an especially valuable segmentation tool because it captures the increasing diversity of the American population. Moreover, it can help even smaller firms identify microsegments that are economically feasible because of lower database costs, more sophisticated software, increased data integration, and wider use of the Internet.[26]

Bases for Segmenting Business Markets

Business markets can be segmented with some variables that are employed in consumer market segmentation, such as geography, benefits sought, and usage rate. Yet business marketers can also use several other variables. Bonoma and Shapiro proposed segmenting the business market with the variables shown in Table 3.6. The demographic variables are the most important, followed by the operating variables—down to the personal characteristics of the buyer.