

# Creating Customer Segments

In this project you, will analyze a dataset containing annual spending amounts for internal structure, to understand the variation in the different types of customers that a wholesale distributor interacts with.

Instructions:

- Run each code block below by pressing **Shift+Enter**, making sure to implement any steps marked with a TODO.
- Answer each question in the space provided by editing the blocks labeled "Answer:".
- When you are done, submit the completed notebook (.ipynb) with all code blocks executed, as well as a .pdf version (File > Download as).

```
In [1]: # Import libraries: NumPy, pandas, matplotlib
import numpy as np
import pandas as pd
import matplotlib.pyplot as plt

# Tell iPython to include plots inline in the notebook
%matplotlib inline

# Read dataset
data = pd.read_csv("wholesale-customers.csv")
print "Dataset has {} rows, {} columns".format(*data.shape)
print data.head() # print the first 5 rows
```

Dataset has 440 rows, 6 columns

	Fresh	Milk	Grocery	Frozen	Detergents_Paper	Delicatessen
0	12669	9656	7561	214	2674	1338
1	7057	9810	9568	1762	3293	1776
2	6353	8808	7684	2405	3516	7844
3	13265	1196	4221	6404	507	1788
4	22615	5410	7198	3915	1777	5185

## Feature Transformation

1) In this section you will be using PCA and ICA to start to understand the structure of the data. Before doing any computations, what do you think will show up in your computations? List one or two ideas for what might show up as the first PCA dimensions, or what type of vectors will show up as ICA dimensions.

Answer:

PCA finds the most significant features that show as much variation across the data. Our dataset is in monetary units indicating how much the customers spend on each product category annually. The first principal component would then show a maximum spread distribution of customers based on their spending.

ICA finds the underlying independent factors that drive the observed features. Given categories of products with amount of spending on each product category, ICA could show different types of customer segments. The idea is we can tell what a customer does base on the products he frequently purchases. For example, if a customer purchases a lot of milk products, it is likely that the customer is a pastry shop. Each customer does not generally affects the purchasing behavior of other customers; therefore we can assume that they are statistically independent. ICA would find these different types of consumer groups from our given observed spending pattern on each product category.

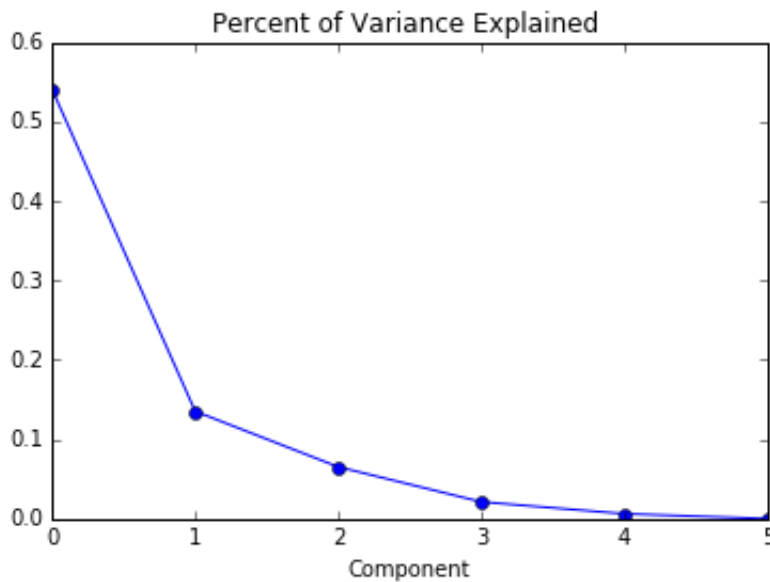
## PCA

```
In [2]: # TODO: Apply PCA with the same number of dimensions as variables in the dataset
from sklearn.decomposition import PCA
pca = PCA(n_components=data.shape[1])
pca.fit(data)

# Print the components and the amount of variance in the data contained in each dimension
print pca.components_
print pca.explained_variance_ratio_

[[-0.97653685 -0.12118407 -0.06154039 -0.15236462  0.00705417 -0.06810471]
 [-0.11061386  0.51580216  0.76460638 -0.01872345  0.36535076  0.05707921]
 [-0.17855726  0.50988675 -0.27578088  0.71420037 -0.20440987  0.28321747]
 [-0.04187648 -0.64564047  0.37546049  0.64629232  0.14938013 -0.02039579]
 [ 0.015986    0.20323566 -0.1602915   0.22018612  0.20793016 -0.91707659]
 [-0.01576316  0.03349187  0.41093894 -0.01328898 -0.87128428 -0.26541687]]
[ 0.45961362  0.40517227  0.07003008  0.04402344  0.01502212  0.00613848]
```

```
In [3]: def plot_variance(variance_ratio):  
        xx = np.arange(variance_ratio.shape[0])  
        plt.plot(xx, 1 - np.cumsum(variance_ratio), '-o')  
        plt.xlabel('Component')  
        plt.title('Percent of Variance Explained')  
        plt.show()  
  
plot_variance(pca.explained_variance_ratio_)
```



**2)** How quickly does the variance drop off by dimension? If you were to use PCA on this dataset, how many dimensions would you choose for your analysis? Why?

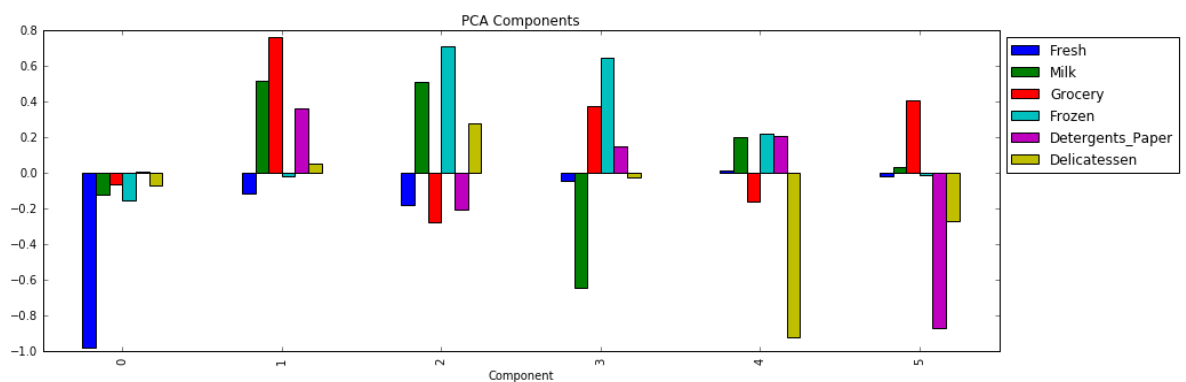
Answer:

The explained variance ratio plummeted on the 3rd principal component.

I'll use 2 dimensions for my analysis. The first 2 components have significantly higher variance compared to the other lower 3 components. The lower 3 components have very low variance, which means if not included in the analysis, there are only minimal information loss when reconstructed back to the original space. Also, 2 dimensions is convenient for visualization purposes.

```
In [4]: def visualize_comp(comp, features=None, title=None):
        labels = features or ["Feature {}".format(i) for i in range(F)]
        df = pd.DataFrame(comp, columns=labels)
        df.index.name = "Component"
        ag = df.plot.bar(figsize=(15, 5), title=title or "Components")
        ag.legend(bbox_to_anchor=(1., 1.), loc="upper left")

        visualize_comp(pca.components_, features=list(data.columns), title
                        ="PCA Components")
```



```
In [5]: from sklearn.preprocessing import MinMaxScaler

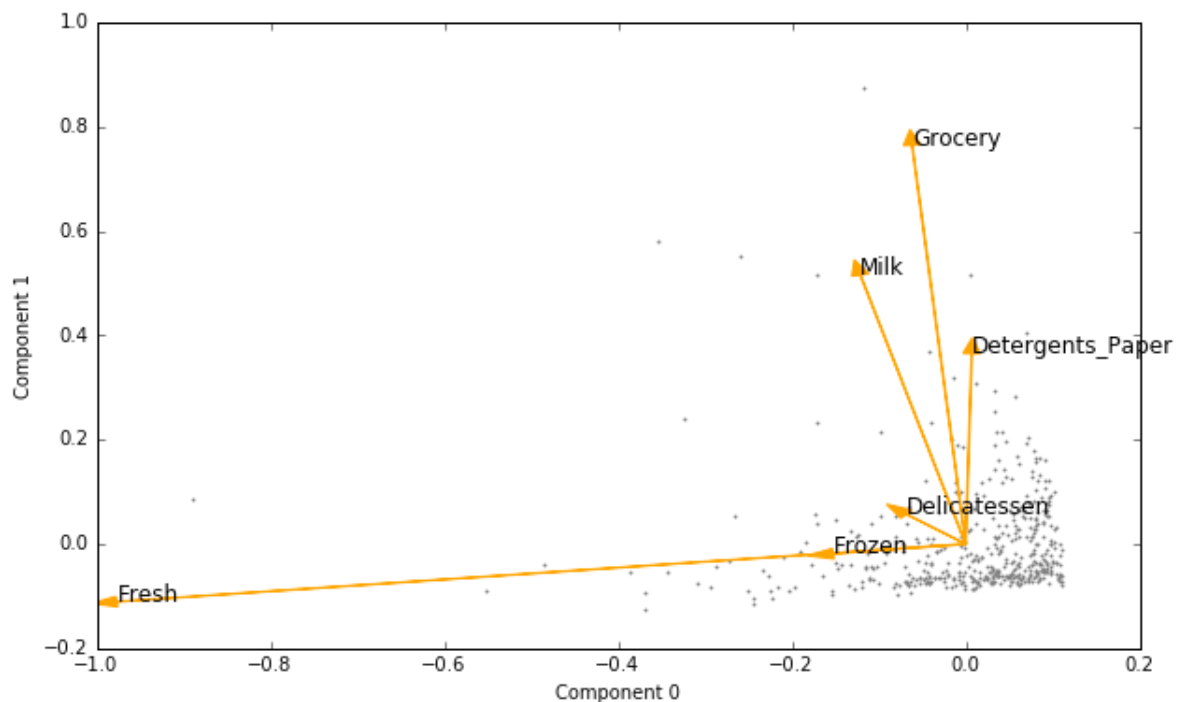
def biplot(t_data, components, labels):
    scaler = MinMaxScaler().fit(t_data)
    means = scaler.transform(t_data.mean(axis=0).reshape(1, -1))
    t_data = scaler.transform(t_data) - means

    plt.figure(figsize=(10, 6))
    plt.scatter(t_data[:, 0], t_data[:, 1], s=0.8, color='gray')

    for label, (xc, yc) in zip(labels, np.c_[components[0], components[1]]):
        plt.arrow(0, 0, xc, yc, width=0.001, fc='orange', ec='orange')
        plt.annotate(label, (xc, yc), size=12, color='k')

    plt.xlabel('Component 0')
    plt.ylabel('Component 1')
    plt.show()

# Plot first 2 components
biplot(pca.transform(data)[: , :2], components=pca.components_[:2],
labels=data.columns)
```



3) What do the dimensions seem to represent? How can you use this information?

Answer:

Each component seems to represent broader categories of products. Component 1 shows milk, grocery, and detergents and paper products go along together and have strong relationship. Component 0 shows fresh products are an entirely different category by itself.

The first component is strongly influenced by fresh product, and some milk and frozen products. This indicates that most variation of customers is in terms of purchasing fresh products.

The second component is influenced by grocery, milk, and detergent and paper products.

By grouping together categories with strong relationship, the dimensionality of the dataset is reduced while minimizing the information loss on the annual spending on the categories.

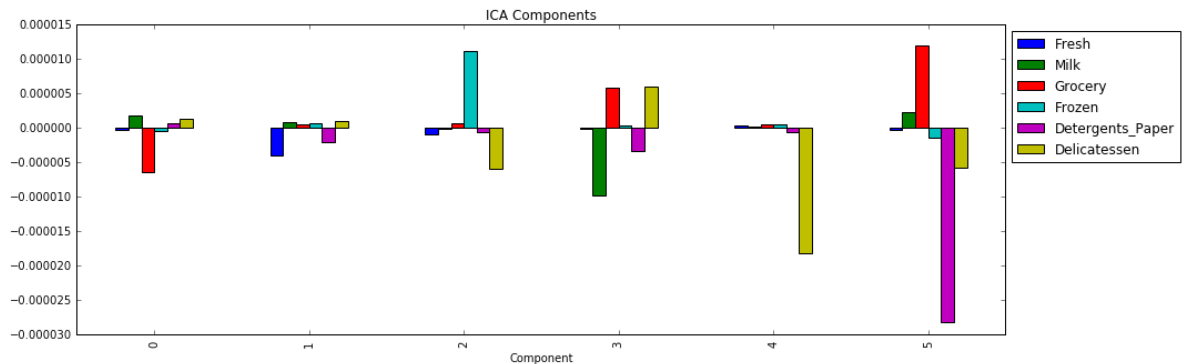
## ICA

```
In [6]: # TODO: Fit an ICA model to the data
# Note: Adjust the data to have center at the origin first!
from sklearn.decomposition import FastICA
ica = FastICA()
centered_data = data - data.mean()
ica.fit(centered_data)

# Print the independent components
print ica.components_

[[ -2.10933472e-07   1.89309849e-06  -6.38565915e-06  -4.16468279e-07
    7.12428845e-07   1.43380337e-06]
 [ -3.97577846e-06   8.57978853e-07   6.18424476e-07   6.77630934e-07
   -2.04874520e-06   1.04678980e-06]
 [ -8.65447502e-07  -1.40338048e-07   7.74220132e-07   1.11460167e-05
   -5.55924175e-07  -5.94838991e-06]
 [ -1.53480062e-07  -9.84566583e-06   5.80883596e-06   3.64010037e-07
   -3.31251798e-06   6.05795415e-06]
 [  3.86180121e-07   2.19461449e-07   6.01551056e-07   5.24545069e-07
   -5.10883449e-07  -1.80940594e-05]
 [ -3.00996789e-07   2.30023472e-06   1.20818001e-05  -1.46144854e-06
   -2.82104165e-05  -5.73458184e-06]]
```

```
In [7]: visualize_comp(ica.components_, features=list(data.columns), title="ICA Components")
```



4) For each vector in the ICA decomposition, write a sentence or two explaining what sort of object or property it corresponds to. What could these components be used for?

Answer:

**Component 0:** Corresponds to convenience/retail stores. It is dominated by grocery products, which indicates that the customer is most likely reselling those products.

**Component 1:** Corresponds to restaurants. It is dominated by fresh products and some detergent and paper products. Restaurants usually have suppliers for fresh produce for their menus. The need for kitchen supplies would explain their demand for detergent and paper products.

**Component 2:** Corresponds to fast food shops. It is dominated by frozen products. Fast food shops normally have frozen supplies for their products.

**Component 3:** Corresponds to cafés. A good portion of milk products, and detergent and paper products, this customer may be operating cafés.

**Component 4:** Corresponds to deli counters. Delicatessen is the only dominant feature, which strongly suggests that these customers operate deli counters.

**Component 5:** Corresponds to grocery stores or hotels. Customers with high demand for grocery products, but not paper products could represent grocery store customers, while the opposite would be true for hotel customers.

These components could be used for identifying different types of customers. By identifying the type of customers, we can understand their shopping habits. Business decisions or sales/promotions can be made targeted to specific customer groups.

# Clustering

In this section you will choose either K Means clustering or Gaussian Mixed Models clustering, which implements expectation-maximization. Then you will sample elements from the clusters to understand their significance.

## Choose a Cluster Type

5) What are the advantages of using K Means clustering or Gaussian Mixture Models?

Answer:

K-Means	GMM
Uses hard assignments	Uses soft assignments
Represents clusters using a centroid only	Applies probabilities to determine clusters
Works best on globular dataset	Motivated in terms of density modeling
Generates Voronoi-shaped clusters	Each data point belongs to each cluster with a probability
Scales well on large number of samples	Variance and covariance are taken into account
Simple to implement and fast	
Easy to understand	

Our dataset doesn't appear to have an obvious natural globular grouping. Potential clusters will have no sharp decision boundaries, and can easily overlap. A good approach would be to find clusters in terms of density, and each data point will have probabilities to which cluster it most likely belongs. GMM would be appropriate for this case.

6) Below is some starter code to help you visualize some cluster data. The visualization is based on [this demo \(http://scikit-learn.org/stable/auto\\_examples/cluster/plot\\_kmeans\\_digits.html\)](http://scikit-learn.org/stable/auto_examples/cluster/plot_kmeans_digits.html) from the sklearn documentation.

```
In [8]: # Import clustering modules
        from sklearn.cluster import KMeans
        from sklearn.mixture import GMM
```



```
In [9]: # TODO: First we reduce the data to two dimensions using PCA to capture variation  
reduce_fit = PCA(n_components=2).fit(data)  
reduced_data = reduce_fit.transform(data)  
print reduced_data[:10] # print upto 10 elements
```

```
[[ -650.02212207  1585.51909007]  
 [  4426.80497937  4042.45150884]  
 [  4841.9987068   2578.762176  ]  
 [  -990.34643689 -6279.80599663]  
 [-10657.99873116 -2159.72581518]  
 [   2765.96159271  -959.87072713]  
 [    715.55089221 -2013.00226567]  
 [  4474.58366697   1429.49697204]  
 [  6712.09539718 -2205.90915598]  
 [  4823.63435407 13480.55920489]]
```

```

In [10]: # TODO: Implement your clustering algorithm here, and fit it to the
          reduced data for visualization
# The visualizer below assumes your clustering object is named 'clusters'

def grid_search_gmm(X, max_n=6):
    cv_types = ['spherical', 'tied', 'diag', 'full']
    n_counts = [i + 1 for i in range(max_n)]

    best_gmm = {'gmm': None, 'score': np.inf}
    def get_bic(c, i):
        gmm = GMM(n_components=i, covariance_type=c).fit(X)
        score = gmm.bic(X)
        if score < best_gmm['score']:
            best_gmm['gmm'] = gmm
            best_gmm['score'] = score
    return score

    # Get BIC scores across all covariance types, up to max_n components each
    bics = [[get_bic(c, i) for c in cv_types] for i in n_counts]

    # Visualize scores
    df = pd.DataFrame(bics, columns=cv_types, index=n_counts)
    df.index.name = "Number of Components"
    ag = df.plot.bar(figsize=(15, 4), title="BIC Score per Model")
    ag.legend(bbox_to_anchor=(1., 1.), loc="upper left")

    # Annotate best BIC score
    text = "Best score: {0}\nCovariance model: {gmm.covariance_type}\nComponents: {gmm.n_components}" \
           .format(best_gmm['score'], gmm=best_gmm['gmm'])
    c_idx = cv_types.index(best_gmm['gmm'].covariance_type)
    r_idx = n_counts.index(best_gmm['gmm'].n_components)
    ag.annotate(text, xy=(r_idx + c_idx * 0.125 - 0.1875, best_gmm['score']),
                xytext=(r_idx + c_idx * 0.125 - 0.1875, best_gmm['score'] * 1.2),
                ha="center", va="bottom",
                arrowprops=dict(facecolor='orange', shrink=0.05),
                size=10, color='b')

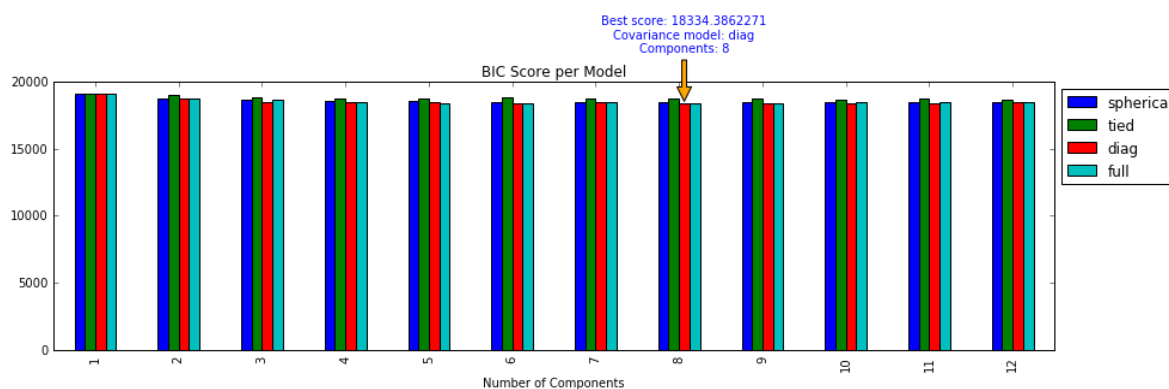
    print text

    return best_gmm['gmm']

clusters = grid_search_gmm(reduced_data, max_n=12)
print clusters

```

```
Best score: 18334.3862271
Covariance model: diag
Components: 8
GMM(covariance_type='diag', init_params='wmc', min_covar=0.001,
    n_components=8, n_init=1, n_iter=100, params='wmc', random_state
=None,
    thresh=None, tol=0.001, verbose=0)
```



```
In [11]: # Plot the decision boundary by building a mesh grid to populate a
graph.
x_min, x_max = reduced_data[:, 0].min() - 1, reduced_data[:, 0].max() + 1
y_min, y_max = reduced_data[:, 1].min() - 1, reduced_data[:, 1].max() + 1
hx = (x_max-x_min)/1000.
hy = (y_max-y_min)/1000.
xx, yy = np.meshgrid(np.arange(x_min, x_max, hx), np.arange(y_min, y_max, hy))

# Obtain labels for each point in mesh. Use last trained model.
z = clusters.predict(np.c_[xx.ravel(), yy.ravel()])
```

```
In [12]: # TODO: Find the centroids for KMeans or the cluster means for GMM

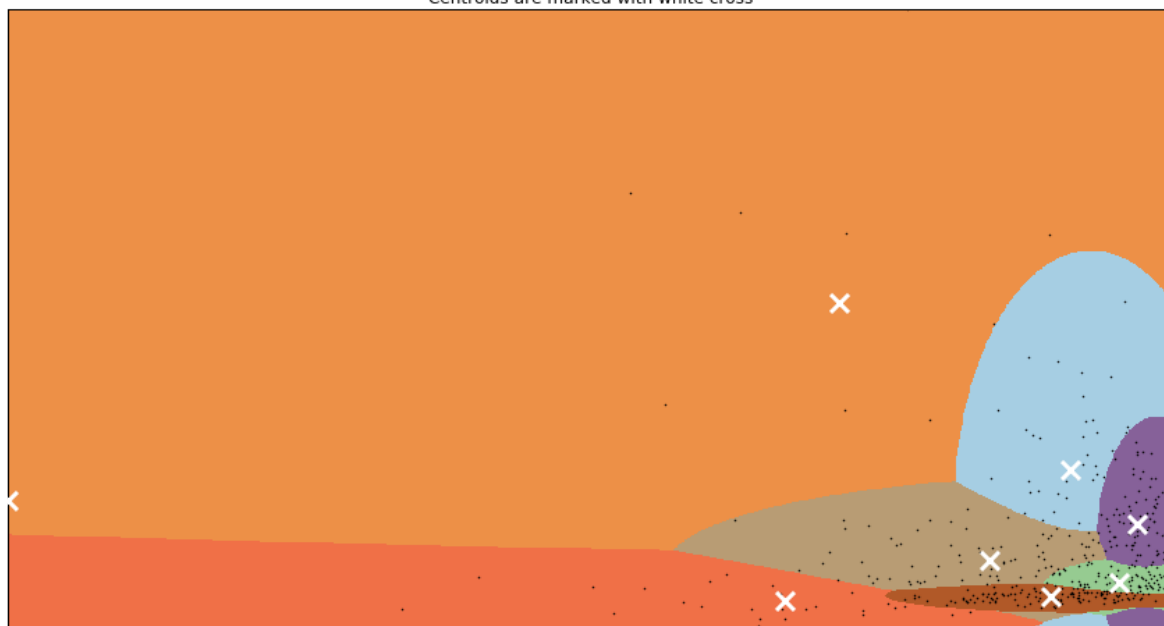
centroids = clusters.means_
print centroids

[[ 2695.93392196 15369.23059417]
 [ 7604.00657794 -5151.96569832]
 [-5419.7277508  -1039.78731669]
 [-26004.65736121 -8382.05609557]
 [-20572.51306444 45689.61637828]
 [ 9394.59036635  5572.38216243]
 [ 713.40193825  -7641.64068318]
 [-103863.42532004 9910.34962857]]
```

```
In [13]: # Put the result into a color plot
Z = Z.reshape(xx.shape)
plt.figure(1, figsize=(15,8))
plt.clf()
plt.imshow(Z, interpolation='nearest',
           extent=(xx.min(), xx.max(), yy.min(), yy.max()),
           cmap=plt.cm.Paired,
           aspect='auto', origin='lower')

plt.plot(reduced_data[:, 0], reduced_data[:, 1], 'k.', markersize=
2)
plt.scatter(centroids[:, 0], centroids[:, 1],
           marker='x', s=169, linewidths=3,
           color='w', zorder=10)
plt.title('Clustering on the wholesale grocery dataset (PCA-reduced
data)\n'
          'Centroids are marked with white cross')
plt.xlim(x_min, x_max)
plt.ylim(y_min, y_max)
plt.xticks(())
plt.yticks(())
plt.show()
```

Clustering on the wholesale grocery dataset (PCA-reduced data)  
Centroids are marked with white cross

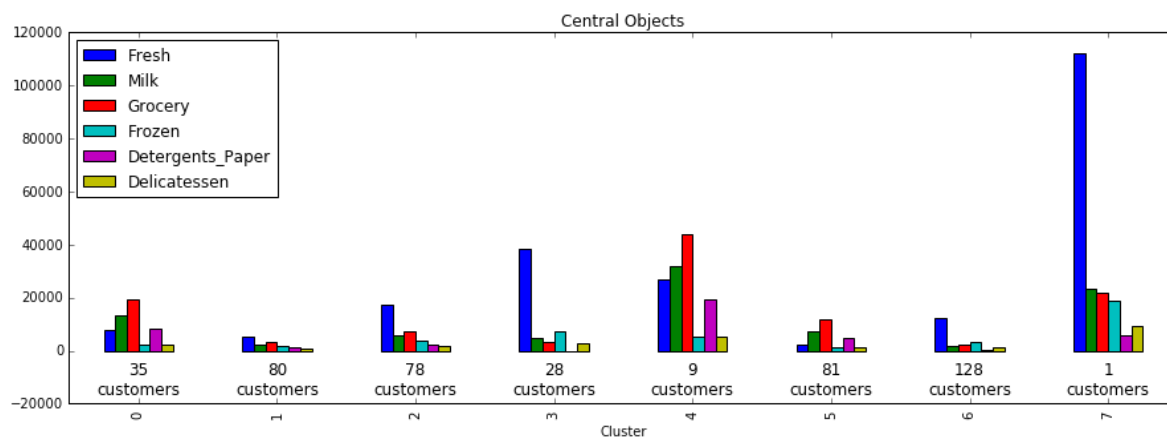


```
In [14]: def plot_cenral_objects(central_objects, counts, features):

    # Visualize scores
    df = pd.DataFrame(central_objects, columns=features)
    df.index.name = "Cluster"
    ag = df.plot.bar(figsize=(15, 5), title="Central Objects")
    ag.legend(loc="upper left")

    # Show number of customers in each cluster
    for i, count in enumerate(counts):
        ag.annotate("{}\ncustomers".format(count),
                    xy=(i, -4000), ha="center", va="top",
                    size=12, color='k')

    plot_cenral_objects(reduce_fit.inverse_transform(centroids),
                        np.bincount(clusters.predict(reduced_data)),
                        list(data.columns))
```



7) What are the central objects in each cluster? Describe them as customers.

Answer:

There appears to be several clusters that have similar purchasing pattern, but with varying volumes.

Clusters 0, 4, and 5 spend mostly on groceries, milk, and detergent and paper products with similar ratio between the categories. They vary in overall volume, which can be classified as high, medium, low volume grocery products customers; cluster 4 being high, cluster 0 being medium, and cluster 5 being low. It can also be noted that there is a low number of customers in the high volume cluster.

There is only 1 customer in cluster 7, and have a very significant value on fresh products. This could be an encoding error, or there is actually 1 special customer who loves fresh products a little too much. Either way, this data point is a definite outlier.

Clusters 3 and 6 are significantly dominated by fresh products, while there are very low amount of other products. They can be categorized as high (cluster 3) and low (cluster 6) volume fresh products customers. Most customers fall on low volume fresh product category, and there are a significantly lower number of customers in the high volume category.

Clusters 1 and 2 have similar purchasing pattern. They are dominated by fresh products as well, however they also have a good portion of other product categories. They can be classified as high (cluster 2) and low (cluster 1) volume general customers. There is an equal distribution of customers between these high and low categories.

To summarize:

Customer Type	High Volume	Medium Volume	Low Volume
Grocery Shoppers	9	35	81
Fresh Shoppers	28	N/A	128
General Shoppers	78	N/A	80

## Conclusions

8) Which of these techniques did you feel gave you the most insight into the data?

Answer:

All three techniques gave useful insights into the data, depending on what we want to see. PCA showed the relationship of product demands between product categories. ICA showed different types of customers. Clustering showed low and high volume customers.

Clustering uncovered the most hidden information in the dataset. It showed groups of customers with similar shopping pattern based on the categories of products, and the same time showed groups with similar volume of spending for each pattern. It also showed the distribution of customers in each category, and it uncovered an outlier.

**9)** How would you use that technique to help the company design new experiments?

Answer:

Using a combination of these techniques, we can compartmentalize customers into different groups. New experiments can be designed to target specific groups and see which groups yield positive or negative results.

For example, we want to test evening delivery. Our hypothesis is evening delivery will increase customer satisfaction. In clustering, we have identified 78 customers as high-volume general shoppers. Fifty percent of these customer group can but put on the new delivery method (Group A), while the remaining 50% stays on the current (Group B). If for example there is more satisfied customer in Group A, then we can conclude that evening delivery increases customer satisfaction for high-volume general customers. If there are equal satisfied customers between the groups, then evening delivery has no effect. If there are more satisfied customers in Group B, then evening delivery has negative effect.

This test result may only be true for high-volume general shoppers, and not for other customer segments. The same test can be conducted again, but this time targeted to other customer groups. Depending on conversion rate on each group, we selectively apply the new evening delivery only to those customer groups that responded very well on the test.

**10)** How would you use that data to help you predict future customer needs?



Answer:

With these data, we can see patterns in customer habits, and assess their needs from these.

Clustering allowed us to identify groups of similar customers, which were previously unlabeled. Similar customers most likely have similar needs and characteristics. With the use of GMM that was trained on our dataset, we can predict any customer as to which customer segment it belongs (e.g. high-volume grocery shopper, low-volume fresh shopper, etc.).

With the result of our clustering, we can analyze the characteristics (e.g. business type, location, industry, capitalization, etc.) of customers belonging to the same clusters, i.e. setting the clusters as labels for our data points. Now that we have labels, we can now perform supervised learning in our data set.

With the model trained from the supervised learning, we can predict a new customer as to which customer segment it will most likely belong. Knowing its group, we can assess its shopping pattern and needs, and apply what we already have in store for this group, such as offering evening delivery.