Market Segmentation

1. Introduction

Marketing segmentation is a critical component of marketing planning, encompassing both strategic and tactical aspects. The strategic marketing plan focuses on the long-term direction of an organization, outlining its goals and why they are pursued. On the other hand, the tactical marketing plan translates the strategic objectives into detailed short-term actions. It is essential to think of this process as planning a hiking expedition, where choosing the mountain to climb (strategic decision) precedes decisions like selecting hiking gear and departure time (tactical decisions).

Strategic marketing planning begins with a SWOT analysis, which identifies an organization's strengths, weaknesses, opportunities, and threats. Concurrently, market research explores consumer needs and desires through various methodologies. Once these elements are in place, two critical decisions must be made: segmenting and targeting specific consumer groups and establishing the organization's market image (positioning).

Tactical marketing planning encompasses product development, pricing, distribution channel selection, and promotional strategies. The tactical plan depends on the strategic plan, emphasizing the importance of a sound long-term strategy. The two plans are illustrated as asymmetrical, with strategic marketing forming the foundation for success. Even excellent tactical marketing cannot compensate for a flawed strategic plan. The best results come from a combination of strong strategic and tactical marketing, while poor strategic planning results in failure, which can be slow or rapid, depending on the effectiveness of tactical efforts. In contrast, good strategic planning combined with inadequate tactical execution ensures survival but may not lead to optimal outcomes.

2. Definitions of Market Segmentation:

Market segmentation is a fundamental tool for marketing managers, aiding in the selection of a target market for a specific product and the creation of an appropriate marketing mix. It is a critical element of strategic marketing, with successful companies relying heavily on segmentation to drive their business decisions. Market segmentation is the practice of viewing a heterogeneous market as several smaller homogeneous markets. The criteria used for this segmentation can be single or multiple consumer characteristics, such as age, gender, benefits sought, or values held.

Market segmentation ensures that a company tailors its products and marketing strategies to distinct consumer segments, ultimately leading to organizational success. A concentrated market strategy involves focusing on one segment to satisfy its specific needs. In contrast, a differentiated strategy customizes products and marketing for multiple segments. An undifferentiated strategy is for those who market a single product to the entire market, typically in resource-rich scenarios or with newly introduced products.

3. The Benefits of Market Segmentation:

Market segmentation has several advantages, including encouraging organizations to reflect on their strengths and what consumers want. When executed effectively, it results in a better alignment between organizational strengths and consumer needs, leading to a competitive edge in the selected segments. Long-term competitive advantage, market dominance, and niche segment success can be achieved. A well-designed marketing mix delivers a higher return on investment, especially for smaller organizations that must focus on distinct needs to survive. Market segmentation is effective in sales management, team building, and communication across organizational units.

4. The Costs of Market Segmentation:

Implementing market segmentation requires a significant investment of time, human resources, and financial resources. The upfront investment is substantial, and if not done effectively, it may lead to wasted resources without a competitive advantage. Organizations must carefully consider the decision to engage in market segmentation analysis and strategy to ensure it is worth the commitment of resources.

In summary, market segmentation is an indispensable tool for marketing managers, offering numerous benefits in terms of competitive advantage and a better return on investment, but it comes with substantial upfront costs and should be undertaken thoughtfully.

5. The Layers of Market Segmentation Analysis:

Market segmentation analysis is the process of grouping consumers based on similar product preferences or characteristics. It involves multiple layers:

The core layer were statistical analysis extracts market segments from consumer data.

The second layer, which includes technical tasks like collecting good data, exploring data, and profiling and describing segments.

The third layer, which involves non-technical organizational implementation tasks, such as deciding to segment, selecting target segments, and developing a customized marketing mix.

6. Approaches to Market Segmentation Analysis:

Market segmentation analysis can be categorized based on organizational constraints and the choice of segmentation variables.

Based on Organizational Constraints:

Segment Revolution: Involves radical changes in marketing strategies, starting from scratch based on segmentation findings.

Segment Evolution: Refines existing strategies and segments.

Segment Mutation: Discovers segments unexpectedly during exploratory research or data mining.

Based on the Choice of Segmentation Variables:

A Priori Segmentation: Uses a single segmentation variable or common sense to create segments based on intuition, secondary data, or existing segments.

Data-Driven Segmentation: Utilizes multiple segmentation variables and conducts data analysis to identify segments. Also known as a posteriori segmentation.

In practice, combinations of these approaches are often used, and multi-stage segmentation can be beneficial for gaining insights into market segments.

7. Data Structure and Data-Driven Market Segmentation Approaches

Market segments often don't naturally exist in consumer data.

The idea of creating artificial segments for marketing purposes is gaining acceptance.

Three conceptual approaches to data-driven segmentation are natural segmentation (finding distinct segments), reproducible segmentation (repeatedly generating the same segments), and constructive segmentation (creating segments even when there's no clear structure).

8. Market Segmentation Analysis Step-by-Step

A ten-step approach to market segmentation analysis is recommended, with a common structure for both commonsense and data-driven segmentation.

The steps include deciding to segment, specifying the ideal target segment, collecting data, exploring data, extracting segments, profiling segments, describing segments, selecting target segments, customizing the marketing mix, and evaluating and monitoring the success of the segmentation strategy.

Step 1: Deciding (not) to Segment

Implications of Committing to Market Segmentation: Market segmentation is a strategic marketing approach, and committing to this strategy has several significant implications:

1. **Long-Term Commitment:** Market segmentation is a long-term commitment. It's not a short-term strategy but more like a marriage than a casual date. Committing to market segmentation requires an organization to invest resources, time, and effort over a sustained period.
2. **Resource Investment:** Pursuing a market segmentation strategy involves costs, including research expenses, data collection, conducting surveys, focus groups, product development or modification, designing marketing packages, and creating advertising materials. These costs should be justified by the expected increase in sales due to segmentation.
3. **Organizational Changes:** Organizations may need to make substantial changes, such as developing new products, altering existing products, adjusting pricing strategies, and changing distribution channels. These changes could also impact the internal structure of the organization.
4. **Commitment from Senior Management:** Senior leadership within the organization must actively support and lead the market segmentation effort. Their involvement is crucial for its success.
5. **Ongoing Communication:** The commitment to market segmentation must be systematically communicated and reinforced across all organizational levels. This ensures that the strategy is followed and maintained consistently.

Implementation Barriers: Several barriers can impede the successful implementation of a market segmentation strategy:

1. **Senior Management:** Lack of leadership and commitment from senior management can undermine the success of market segmentation. Adequate resources should be made available for both the initial analysis and the long-term implementation.
2. **Organizational Culture:** A culture that lacks a market or consumer orientation, resists change, is not creative, has poor communication, and engages in office politics can hinder segmentation efforts.
3. **Training:** A lack of understanding of market segmentation fundamentals among senior management or the segmentation team can lead to failure. Adequate training is necessary.

4. **Marketing Function:** Organizations with limited or no formal marketing function or qualified marketing experts may struggle with implementing market segmentation.
5. **Data and Analysis:** A lack of qualified data managers and analysts can pose significant challenges.
6. **Financial and Structural Restrictions:** Objective restrictions such as financial constraints or an inability to make necessary structural changes can be obstacles.
7. **Process-Related Barriers:** Lack of clear objectives, poor planning, unstructured processes, a lack of responsibility allocation, and time pressure can also impede success.

Step 2: Specifying the Ideal Target Segment

In this step, the focus is on defining the criteria for evaluating potential market segments. It is important to consider both "knock-out criteria" and "attractiveness criteria" to determine which market segments are worth pursuing. These criteria will guide your choices in later steps, including data collection and segment selection.

Segment Evaluation Criteria:

- **User Involvement:** User input throughout the process is essential. Their involvement guides many subsequent steps, particularly data collection and segment selection.
- **Knock-Out Criteria:** These are non-negotiable criteria that segments must meet to be considered for further evaluation.
- **Attractiveness Criteria***:* These criteria are used to assess the relative attractiveness of the remaining market segments, helping you select one or more target segments.

A variety of criteria are available in the literature to evaluate market segments. Some of the proposed criteria include:

- Measurable, substantial, and accessible segments.
- Competitive advantage, profitability, and sensitivity to price.
- Barriers to entry, growth potential, and socio-political factors.
- Compatibility with the company's strengths, and the identification of segments.
- Reachability, actionability, and responsiveness.
- Identifiability, profitability, and differentiability.

4.2 Knock-Out Criteria: Knock-out criteria are essential factors that segments must meet to proceed with further evaluation. Some commonly recognized knock-out criteria include:

- **Homogeneity:** Members within the segment should be similar to each other.
- **Distinctiveness:** The segment should be distinct from other segments.
- **Size:** The segment should be large enough to warrant the customization of marketing efforts.
- **Matching Organizational Strengths:** The organization must be capable of satisfying the needs of segment members.
- **Identifiability:** It should be possible to identify segment members in the marketplace.
- **Reachability:** There must be a means to contact segment members for marketing efforts.

The specific minimum size of a target segment should be determined based on your organization's resources and goals.

4.3 Attractiveness Criteria: Attractiveness criteria are used to evaluate the relative attractiveness of remaining market segments. These criteria are more diverse and subjective, so they allow for a deeper assessment of each segment. The selection of attractiveness criteria should be a collaborative process involving the segmentation team and should be based on your specific business needs.

4.4 Implementing a Structured Process: Implementing a structured process for evaluating market segments is essential. A common approach is to use a segment evaluation plot that compares segment attractiveness and organizational competitiveness. It's important to keep this process concise by focusing on no more than six key criteria. Involving representatives from various organizational units is crucial to capture different perspectives and ensure a successful implementation of the segmentation strategy throughout the organization.

Step 3: Collecting Data

a. **Segmentation Variables**:

- Empirical data serves as the foundation for both commonsense and data-driven market segmentation. It is employed to identify or create market segments.
- In this context, we use the term "segmentation variable" to refer to the characteristic used. In commonsense segmentation, this variable is often a singular trait of a consumer within the sample. Each row in the table represents an individual consumer, with each variable representing one of their characteristics. A value of 1 indicates the presence of the characteristic, while 0 indicates its absence. The same principle applies to data-driven market segments, impacting the quality of the descriptions of the resulting segments. Sound market segmentation analysis hinges on the availability of robust empirical data.

b. **Segmentation Criteria**:

- Well before extracting segments or collecting data for this purpose, an organization faces a pivotal decision: the choice of segmentation criteria. The most prevalent criteria are geographic, sociodemographic, psychographic, and behavioral. The ideal choice depends on the compatibility with the product or service and its cost-effectiveness.

1. **Geographic Segmentation**: Geographic information is historically the primary criterion for market segmentation. Typically, a consumer's place of residence is the sole basis for forming market segments. For instance, Amazon may sell its Kindle online using a unified webpage, with customers indicating their country of residence for country-specific information. Similarly, IKEA offers a consistent product range worldwide, but slight variations exist based on geographic location.
2. **Socio-Demographic Segmentation**: Socio-demographic criteria typically encompass factors like age, gender, income, and education. While effective in specific industries, they may not always provide insights into the true drivers of consumer preferences.
3. **Psychographic Segmentation**: Psychographic segmentation groups people based on psychological aspects such as beliefs, interests, preferences, aspirations, or sought-after benefits when purchasing a product. Lifestyle segmentation, based on activities, opinions, and interests, is a popular approach. Psychographic criteria are inherently more intricate than geographic or sociodemographic criteria because they delve into multifaceted dimensions of a person's psyche.
4. **Behavioural Segmentation**: This approach seeks similarities in behaviour or reported behaviour directly. A wide array of behaviours can be used for this purpose, including prior product experiences, purchase frequency, expenditure per purchase, and information-seeking behaviour. The advantage of behavioural approaches is that they rely on actual behaviour rather than self-reported or intended behaviour.