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What is Market Segmentation?

Market segmentation is a marketing strategy that involves dividing a broad target market into subsets of consumers who have common needs, preferences, or behaviours, and then designing and implementing strategies to target these specific segments effectively. The purpose of market segmentation is to identify and understand distinct groups of consumers within a larger market to better tailor products, services, and marketing efforts to meet their specific needs.

There are various ways to segment a market, including:

1. Demographic segmentation: Dividing the market based on demographic variables such as age, gender, income, education, occupation, marital status, and family size.
2. Geographic segmentation: Segmenting the market based on geographic variables such as region, country, city size, climate, and population density.
3. Psychographic segmentation: Dividing the market based on psychographic variables such as lifestyle, personality, values, attitudes, interests, and opinions.
4. Behavioural segmentation: Segmenting the market based on consumer behavior, such as usage rate, brand loyalty, purchase occasion, benefits sought, and readiness to buy.

Market segmentation helps businesses to:

- Identify and understand the diverse needs and preferences of different customer groups.
- Develop targeted marketing strategies that resonate with specific segments.
- Allocate resources more effectively by focusing on high-potential segments.
- Differentiate their products or services to better meet the needs of specific segments.
- Enhance customer satisfaction and loyalty by delivering more relevant offerings and messaging.

Step-1 Deciding (not) to Segment:

Market segmentation is a marriage, not a date.

Implications of Committing to Market Segmentation

The passage highlights several key implications of pursuing a market segmentation strategy:

1. Long-term commitment: Market segmentation is not a short-term tactic but a long-term strategy. Organizations must commit to it for the foreseeable future. This commitment involves substantial changes and investments, including research, product development, marketing communication, and organizational restructuring.

2. Costs: Implementing market segmentation incurs various costs, such as research expenses, designing multiple marketing materials, and potentially developing or modifying products. These costs must be justified by the expected increase in sales and profitability.

3. Changes in products, pricing, and distribution: Market segmentation may require organizations to develop new products or modify existing ones to better meet the needs of specific segments. Pricing strategies and distribution channels may also need adjustment based on segment preferences.

4. Organizational structure: To effectively implement market segmentation, organizations may need to restructure internally. Croft (1994) suggests organizing around market segments rather than products, with strategic business units dedicated to serving specific segments.

5. Executive-level decision-making: Given the significant implications and long-term commitment required, the decision to pursue market segmentation should be made at the highest executive level. It should be systematically communicated and reinforced throughout the organization to ensure alignment and commitment across all levels and units.

Implementation Barriers

1. Senior management: Lack of leadership, proactive championing, commitment, and involvement by senior leadership can undermine the success of market segmentation. Insufficient allocation of resources by senior management for both the initial analysis and long-term implementation of the strategy can also hinder success.
2. Organizational culture: Barriers related to organizational culture include a lack of market or consumer orientation, resistance to change, lack of creative thinking, poor communication, short-term thinking, unwillingness to make changes, and office politics. These factors can prevent effective implementation of market segmentation.
3. Lack of training: If senior management and the segmentation team do not understand the fundamentals of market segmentation or the implications of pursuing such a strategy, the attempt to introduce market segmentation is likely to fail.
4. Absence of marketing expertise: The lack of a formal marketing function or qualified marketing experts within the organization can hinder successful market segmentation. Additionally, the absence of a qualified data manager and analyst can be a major obstacle.
5. Objective restrictions: Objective restrictions faced by the organization, such as lack of financial resources or the inability to make necessary structural changes, can impede the implementation of market segmentation.
6. Process-related barriers: These include unclear objectives, lack of planning, absence of structured processes, inadequate allocation of responsibilities, and time pressure. These factors can hinder the ability to achieve the best possible segmentation outcome.. Difficulty in understanding: Management may resist using techniques they do not understand. Making market segmentation analysis easy to understand and presenting results in a clear and interpretable manner can help overcome this barrier.

Step 1 Checklist

checklist includes not only tasks, but also a series of questions which, if not answered in the affirmative, serve as knockout criteria

Task	Who is responsible?	Completed?
Ask if the organisation's culture is market-oriented. If yes, proceed. If no, seriously consider not to proceed.		<input type="checkbox"/>
Ask if the organisation is genuinely willing to change. If yes, proceed. If no, seriously consider not to proceed.		<input type="checkbox"/>
Ask if the organisation takes a long-term perspective. If yes, proceed. If no, seriously consider not to proceed.		<input type="checkbox"/>
Ask if the organisation is open to new ideas. If yes, proceed. If no, seriously consider not to proceed.		<input type="checkbox"/>
Ask if communication across organisational units is good. If yes, proceed. If no, seriously consider not to proceed.		<input type="checkbox"/>
Ask if the organisation is in the position to make significant (structural) changes. If yes, proceed. If no, seriously consider not to proceed.		<input type="checkbox"/>
Ask if the organisation has sufficient financial resources to support a market segmentation strategy. If yes, proceed. If no, seriously consider not to proceed.		<input type="checkbox"/>
Secure visible commitment to market segmentation from senior management.		<input type="checkbox"/>
Secure active involvement of senior management in the market segmentation analysis.		<input type="checkbox"/>
Secure required financial commitment from senior management.		<input type="checkbox"/>
Ensure that the market segmentation concept is fully understood. If it is not: conduct training until the market segmentation concept is fully understood.		<input type="checkbox"/>

Step 2: Specifying the Ideal Target Segment

Segment Evaluation Criteria

During Step 2, the organization is tasked with determining two sets of segment evaluation criteria:

Knock-out criteria: These are essential features of segments that are non-negotiable for the organization. Segments failing to meet these criteria are eliminated from consideration.

Attractiveness criteria: These criteria are used to assess the relative attractiveness of the remaining segments that meet the knock-out criteria. While the distinction between these two sets of criteria may not be common in the literature, a wide range of segment evaluation criteria is proposed. These criteria are described at various levels of detail and encompass different aspects relevant to segmentation analysis.

Knock-Out Criteria:

1. **Homogeneity:** Segment members should share similar characteristics or needs, making them homogeneous within the segment.
2. **Distinctiveness:** The segment should be distinct from other segments, with members exhibiting noticeable differences from those in other segments.
3. **Sufficient sizes:** The segment must be large enough to justify the investment required for customizing the marketing mix. It should contain a substantial number of consumers.
4. **Alignment with organizational strengths:** The organization should possess the capabilities to fulfil the needs of segment members effectively.
5. **Identifiability:** Segment members should be identifiable, allowing marketers to recognize them in the marketplace.
6. **Reachability:** There must be accessible means to connect with segment members, facilitating the delivery of customized marketing efforts.

It's crucial for senior management, the segmentation team, and any advisory committees involved to understand these knock-out criteria thoroughly. While most criteria are self-explanatory, some may require further specification.

Attractiveness Criteria

Attractiveness criteria are not binary in nature. Segments are not assessed as either complying or not complying with attractiveness criteria. Rather, each market segment can be attractive with respect to criterion. The attractiveness across all criteria determines whether a market segment is useful.

Implementing a Structured Process

Implementing a structured process for evaluating market segments is widely recognized as beneficial in segmentation literature. One popular approach involves using a segment evaluation plot, which depicts segment attractiveness on one axis and organizational competitiveness on the other. However, since there is no universally applicable set of criteria, determining these values requires input from the segmentation team based on factors specific to the organization.

To establish the criteria for segment attractiveness and organizational competitiveness, it's essential to explore a variety of potential factors and then narrow them down to the most relevant ones through negotiation and agreement. McDonald and Dunbar recommend using no more than six factors for this purpose. Ideally, this process involves a team of individuals, with a core team proposing an initial solution for discussion and potential modification by an advisory committee comprising representatives from all organizational units.

Including representatives from various organizational units is crucial because each unit brings a unique perspective, and because the segmentation strategy will impact every unit within the organization.

While the segment evaluation plot cannot be completed in Step 2 of the segmentation analysis (as no segments are available yet), selecting attractiveness criteria early on ensures that relevant information is captured during data collection (Step 3) and simplifies the task of selecting a target segment in Step 8.

By the end of this step, the segmentation team should have approximately six attractiveness criteria, each weighted to indicate its importance relative to others. This weighting is typically determined by allocating 100 points across the criteria and negotiating until agreement is reached. Seeking approval from the advisory committee is optimal, as it represents various organizational perspectives and enhances the robustness of the criteria selection process.

Step 2 Checklist

Task	Who is responsible?	Completed?
Convene a segmentation team meeting.		<input type="checkbox"/>
Discuss and agree on the knock-out criteria of homogeneity, distinctness, size, match, identifiability and reachability. These knock-out criteria will lead to the automatic elimination of market segments which do not comply (in Step 8 at the latest).		<input type="checkbox"/>
Present the knock-out criteria to the advisory committee for discussion and (if required) adjustment.		<input type="checkbox"/>
Individually study available criteria for the assessment of market segment attractiveness.		<input type="checkbox"/>
Discuss the criteria with the other segmentation team members and agree on a subset of no more than six criteria.		<input type="checkbox"/>
Individually distribute 100 points across the segment attractiveness criteria you have agreed upon with the segmentation team. Distribute them in a way that reflects the relative importance of each attractiveness criterion.		<input type="checkbox"/>
Discuss weightings with other segmentation team members and agree on a weighting.		<input type="checkbox"/>
Present the selected segment attractiveness criteria and the proposed weights assigned to each of them to the advisory committee for discussion and (if required) adjustment.		<input type="checkbox"/>

Step 3 – COLLECTING DATA

Market segmentation relies on empirical data to identify or create market segments and describe them in detail. In commonsense segmentation, a single characteristic, termed the segmentation variable, divides the sample into segments. Descriptor variables, such as socio-demographics or travel behaviour, describe these segments in detail.

Data-driven market segmentation, however, employs multiple segmentation variables to identify relevant market segments. These variables serve as the basis for segment identification, with descriptor variables providing additional detail about each segment.

The quality of empirical data is crucial for both commonsense and data-driven segmentation. It ensures accurate assignment of individuals to segments and enables effective segment description, which in turn facilitates customized product development, pricing strategies, distribution channel selection, and advertising.

Empirical data for segmentation studies can be sourced from surveys, observations (e.g. scanner data), or experimental studies. While surveys are common, they may not always accurately reflect behavior, especially for socially desirable actions. Therefore, exploring multiple data sources to find the best reflection of consumer behavior is essential for effective market segmentation analysis.

Before extracting segments or collecting data, organizations must decide on the segmentation criterion, which refers to the nature of the information used for market segmentation. Common segmentation criteria include geographic, socio-demographic, psychographic, and behavioural factors.

Geographic Segmentation:

Geographic information is a traditional segmentation criterion used for market segmentation.

Consumers' location of residence is typically the sole criterion used in geographic segmentation.

Geographic segmentation is advantageous because it allows for easy targeting of communication messages and selection of communication channels.

However, it has limitations as residing in the same area does not necessarily mean sharing other relevant characteristics for marketers.

Despite its shortcomings, geographic segmentation has experienced a resurgence in international market segmentation studies.

International segmentation studies across geographic boundaries present challenges due to the need for meaningful segmentation variables across regions and potential biases from respondents of different cultural backgrounds.

Socio-Demographic Segmentation:

Socio-demographic criteria include age, gender, income, and education.

While useful in some industries, socio-demographic segments may not always explain specific product preferences.

Demographics typically explain a small percentage of consumer behaviour variance.

Values, tastes, and preferences are often considered more influential than sociodemographic in consumer buying decisions.

Psychographic Segmentation:

Psychographic segmentation groups people based on psychological criteria like beliefs, interests, preferences, and benefits sought.

Benefit segmentation and lifestyle segmentation are popular approaches within psychographic segmentation.

Psychographic criteria are more complex than geographic or socio-demographic criteria, often requiring multiple variables for segmentation.

Despite complexity, psychographic segmentation reflects underlying reasons for differences in consumer behaviour.

Behavioural Segmentation:

Behavioural segmentation groups consumers based on similarities in behaviour or reported behaviour.

Behaviours such as prior experience with the product, purchase frequency, and information search behaviour can be used for segmentation.

Behavioural segmentation based on actual behaviour avoids the need for developing valid measures for psychological constructs.

However, behavioural data may not always be readily available, especially for potential customers who haven't purchased the product.

Data Collection:

Most market segmentation analyses rely on survey data, which is cheap and easy to collect.

Careful selection of variables and response options is crucial to ensure data quality and minimize biases.

Sample size requirements vary based on the complexity of the segmentation problem and data characteristics, but larger samples generally improve segmentation accuracy.

Internal data from organizations can be valuable for segmentation but may be biased towards existing customers.

Experimental data from field or laboratory experiments can also inform segmentation analysis, providing insights into consumer preferences and behaviour.

Step 3 Checklist:

The Step 3 Checklist outlines tasks for convening a market segmentation team meeting, discussing potential segmentation variables, planning data collection, and ensuring data quality throughout the process

Task	Who is responsible?	Completed?
Convene a market segmentation team meeting.		<input type="checkbox"/>
Discuss which consumer characteristics could serve as promising segmentation variables. These variables will be used to extract groups of consumers from the data.		<input type="checkbox"/>
Discuss which other consumer characteristics are required to develop a good understanding of market segments. These variables will later be used to describe the segments in detail.		<input type="checkbox"/>
Determine how you can collect data to most validly capture both the segmentation variables and the descriptor variables.		<input type="checkbox"/>
Design data collection carefully to keep data contamination through biases and other sources of systematic error to a minimum.		<input type="checkbox"/>
Collect data.		<input type="checkbox"/>