



Segmentation and Customer Loyalty

Using Segmentation to Strengthen Customer Loyalty

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Executive Summary

Loyal customers are important to businesses because they offer a steady revenue stream, higher profit margins and enthusiastic referrals. But in a down economy, price sensitivity can trump loyalty. To strengthen the bonds with these high-profit potential customers, innovative companies are deploying enterprise-wide strategies built on consumer segmentation. These strategies go beyond the classic marketing applications of segmentation to drive customer-facing aspects of a business. Among the strategies:

- Real estate departments select sites based on surrounding population profiles
- Stores are remodeled to meet the needs of specific target groups
- Customer service departments differentiate their response scripts according to how long a caller has been a patron
- Merchandise is fine-tuned to meet the lifestyle preferences of the most loyal customers and those with highest profit potential

At Nielsen, analysts have developed a framework for achieving customer loyalty:

- Identify the best consumer segments
- Create the top target groups and develop detailed lifestyle and behavior profiles
- Deploy enterprise-wide strategies that take into account these profiles
- Measure effectiveness and adjust strategy to maximize ROI

Because this framework crosses functional boundaries, managers may face resistance to their deployment. But a well-executed enterprise-wide segmentation effort can

strengthen customer loyalty and position a company for even better performance when a healthier economy returns.

Introduction

Customer loyalty comes in many forms: consumers who wouldn't think of buying a car from another dealer, shoppers who are on a first-name basis with a boutique store clerk, coffee shop regulars who don't even need to place an order to get their half-caf, no-whip soy latte. Loyal customers, built one positive experience at a time, provide businesses with a steady revenue stream, higher profit margins and confirmed evangelists who virtually—and sometimes virally—do much of their marketing for them.

But with the U.S. economy undergoing a wrenching recession, maintaining customer loyalty is more critical—and challenging—than ever. Industries ranging from banking to telecommunications are scrambling to remain profitable amid dampened consumer spending, high unemployment and financial uncertainty. At the same time, companies are cutting back their marketing budgets and preferred customer rewards programs as cost-saving measures. Twenty-five years after Neiman Marcus introduced the first customer loyalty program, nationwide surveys have reported a decline in corporate allegiance as consumers shift their concerns from patronage to price.

An example of this is when the Nielsen Convergence Audit surveyed 38,000 Americans about their technology purchases, 24 percent said they had switched their cell



phone, cable TV and Internet service providers in the last six months of 2008. But one upside to the economic downturn is that companies are becoming more customer centric to build long-term value. To make sure they hold on to their most valuable customers, many companies are taking a second look at a classic marketing tool—consumer segmentation—and applying its concepts in new and innovative ways. With consumer segmentation, businesses classify their customers according to shared demographic, lifestyle and behavioral traits. Then they focus their marketing and merchandising efforts on the segments that offer the highest profit potential. The results—increased brand loyalty, higher direct marketing response rates and improved customer acquisition and retention—help explain why consumer segmentation in the U.S. market research industry is a multi-million dollar business.

The strategy has also become more valuable in the current recession as companies face greater competition in a down market, according to Morris Holbrook, Ph.D., a professor of marketing at Columbia University. "Consumer segmentation doesn't just provide companies with more data to better serve more customers," says Holbrook.



"They don't have to go after customers that are more loyal to competitors. They can concentrate on segments that are strong while shedding segments that are weak."

While segmentation was initially developed as a tool for market research, the latest applications are taking root as a sophisticated, enterprise-wide strategy. Multiple departments within a company now use segmentation initiatives for customer acquisition, product development, cross-selling, up-selling, customer relationship management, media planning, site location analysis and merchandising. But to reap such gains, the organization has to embrace a segmentation framework as a way to build customer loyalty and increase revenue. Only by deepening the relationship with its best customers from multiple touch-points will a company be able to compete more effectively during the recession and grow its loyal customer base when a healthier economy returns.

Realigning Operations through Segmentation

Consumer segmentation has been around for nearly four decades, and it's been proven effective in solving a variety of marketing challenges. According to Nielsen, which offers a number of segmentation systems, the response rate of a direct mail campaign that employs lifestyle-based customer segments can be double that of a scattershot

or broad-based mailing. Using consumer segments based on investable assets and lifestyle, a financial services company converted 30 percent more prospects to customers than with prior mass mailings. And when Ace Hardware turned to lifestyle segmentation for a customer retention program, revenues rose 5.4 percent as lapsed customers were enticed by discounts to return to their local Ace stores.

Segmentation has always sought to answer four fundamental questions: Who are my customers? What are they like? Where can I find more of them? What channels and messages should I use to connect with them? Segmentation solutions traditionally answer those questions by analyzing a company's current customer database or syndicated research to identify groups of customers with similar traits and behaviors, such as single women living in urban apartments or married men with college degrees living in exurbia. Companies then target the best-performing customer segments with special product offerings, personalized service, sales incentives and merchandising designed with their lifestyle preferences in mind.

But for companies seeking to become truly customer centric, a segmentation initiative can go well beyond focused marketing pitches to shape virtually every function that touches the customer. Best Buy launched a customer-centric program based on segmentation that now is at the heart of its company-wide growth strategy. According to published reports, the consumer electronics giant, which has more than 1,000 stores nationwide, classified its best customers into five consumer segments, conferring names on them like Buzz (the young tech enthusiast), Jill (the suburban soccer mom) and Barry (the wealthy professional guy). Using a variety of demographic, lifestyle and marketplace

data to flesh out these portraits, Best Buy re-aligned its stores according to the segments. Store clerks received training on how to serve the Barrys or Buzzes in their trade areas, and stores were remodeled to reflect the dominant target groups. As a result of this program, the company invested more than \$50 million to renovate 110 stores.

A store with a strong Jill clientele, for instance, received brightly colored signage, play areas for children, lots of educational toys and personal shopping assistants trained in ways to ease technology angst. The store's design, merchandise and staffing all combined to enhance a Jill's shopping experience—and, of course, maximize company profits. In the year after the makeover, the Best Buy stores that had been converted to the customer-centric model reported same-store sales growth in excess of nine percent—more than double that of outlets that had not been overhauled using the segmentation model.

Typically, segmentation initiatives like the one used by Best Buy augment a company's transactional data with syndicated survey research to create detailed profiles of the customers who account for the most profit. Segmentation systems enhance customer data by linking consumers to a variety of third-party databases that can reliably predict their lifestyles and media preferences through their demographics. Nielsen PRIZM, introduced in 1976, currently classifies all 114 million U.S. households into one of 66 consumer types—with names like *Upper Crust*, *New Empty Nests* and *Shotguns & Pickups*. Drawing on U.S. Census data and market research conducted by companies like Simmons and Mediamark Research & Intelligence, the system puts a human face on every segment's likes and dislikes. Households classified *Money & Brains*, a segment of white-collar professionals living in high-priced urban enclaves, share a

fondness for the arts, international travel, luxury imports, wireless technology and business magazines—whether they live in Princeton, New Jersey or Palo Alto, California.

By appending a PRIZM® code to an address file, any company can begin building stronger relationships with customers through tailored contacts that go beyond mass mailing a discount coupon or buying a 30-second spot on the evening news. Stores in different cities—or even different neighborhoods in the same city—can feature product mixes geared specifically to the lifestyles and preferences of the segments in that area. And once a company finds a specific segment with a high profit potential, the segmentation system can identify areas where more of those kinds of consumers are likely to live and provide insights on what messages will appeal to them.

Loyalty Has Its Privileges

At the *Arizona Republic*, a Gannett newspaper with the largest circulation in Arizona—486,686 Sunday subscribers—consumer segmentation drives its interdisciplinary approach to maintaining customer loyalty. Reporters attend seminars about the most common PRIZM segments among their readers to better craft their stories with their audience in mind. Circulation managers differentiate customer service policies based on whether a subscriber is a long-time reader or a new customer. And marketers target subscription drives to prospects who, according to segmentation data, are most likely to become loyal readers.

To execute this customer-centric approach, the company analyzes its subscriber list to identify longtime readers and then classifies those loyal readers by PRIZM segments based on their addresses. The resulting list of dominant segments is then sorted into five target groups with nicknames like Gold (older, affluent readers from PRIZM segments



like *Upper Crust* and *Blue Blood Estates*) and Silver (younger, upscale residents of segments such as *Young Influentials* and *The Cosmopolitans*). Using a software tool that evaluates customers and markets, analysts identify Arizona neighborhoods with high concentrations of the target groups and the retail areas they are likely to frequent. Knowing where to find people who share the same demographics and lifestyles as its most loyal readers allows the *Arizona Republic* to target its introductory direct mail subscription offers and differentiate its pitch based on the prospects' specific interests. And by setting up kiosks outside the grocery and department stores favored by the various target groups, the paper makes sure it's seen by the people most likely to subscribe.

This approach to finding "look-alike" customers who matched the characteristics of its most loyal segments yields measurable results. Before 2005, when the *Arizona Republic* sought new customers with mass mailings of generic direct mail pieces, 23 percent of respondents canceled their subscriptions after the introductory offer. But in 2007, after the paper segmented and targeted Gold subscriber look-alikes, the drop-out rate fell to just 14 percent—a 39 percent improvement. Just as important, by targeting only selected households, the newspaper

was able to cut printing and postage costs, reducing its acquisition cost per subscriber by 23 percent.

"Segmentation has really cut down on our mailing pieces and costs," says Greg Bright, Director of IT Data Management, who notes the paper now sends out 40 percent fewer direct mail pieces. "We've learned who we're most likely to attract as subscribers and concentrated our efforts with them. Anyone still doing a mass mailing without target group selection is wasting their time and money."

Once the *Arizona Republic* has landed new subscribers, the focus of its segmentation efforts shifts to retaining them. The paper sent longtime Gold readers a thank you note for their loyalty, along with a \$20 gift card to Nordstrom, one of the Gold group's favorite retailers. Silver readers received \$20 gift cards to Target. The segmentation strategy has even guided circulation staffers with a counterintuitive approach to managing customer service problems. If a paper is delivered late to a Gold subscriber, for instance, a simple apology and service credit may be sufficient to assuage a loyal reader. The less loyal readers in the Bronze group, however, receive a longer chat and service credit. "Just by looking at a PRIZM code, we know if someone is going to stay a subscriber no matter what happens," says Bright. "That lets us divert some of our retention dollars to subscribers on the fringes." But he's quick to add that the paper doesn't take its most loyal customers for granted.

Increasing Customer Stickiness

Building customer loyalty through segmentation is not limited to finding new customer look-alikes. It can also help companies keep existing customers from defecting to competitors. When First Tennessee, a Memphis-based regional bank with about 200 branches, decided in 2008 to place a

greater strategic emphasis on becoming customer centric, it employed an innovative approach to address the lifecycle needs of top prospects. The bank drew on both its customer records and data from Nielsen P\$YCLE, a segmentation system that classifies households into 58 types based on demographics and financial behavior. Focusing on a customer's investable assets and lifestyle, First Tennessee identified segments of affluent and mass affluent customers, and divided them further into younger professionals, near retirees and retirees, for a total of six target groups.

After developing lifestyle portraits of the target group members, First Tennessee identified key marketing themes based on the intersection of customer needs and the bank's competitive advantages. With a multi-channel advertising campaign built around the tagline "Powering Your Dreams," the bank tailored individual marketing messages to resonate with its top target groups. For instance, to satisfy the busy professionals who place a high value on convenience, the bank highlighted its extended hours—open until 6 p.m. on weekdays and until 1 p.m. every Saturday—that were 30 percent longer than the competition. Meanwhile, promotions to the near-retirement target group trumpeted its retirement planning services, including the safety of its FDIC-insured savings and CD

products. In a commercial designed to promote how First Tennessee offerings help younger professionals save for a bright future, an African-American couple is shown proudly sending their son off to elementary school. For the near retirees, another spot features a middle-aged couple helping their daughter prepare for her wedding.

"We want our bank to resonate with the lifestyle and financial needs of our target audience," says Dan Marks, Chief Marketing Officer at First Tennessee, "so we emphasize the competitive advantages that we know resonate with our customers and use our products as the call to action."

Marks notes that P\$YCLE® is especially useful in understanding the lifestyle context and full wallet opportunity of a customer in order to anticipate their financial needs. For example, when a customer opens a \$5,000 checking account, most banks don't know whether the balance represents most or only a small portion of the individual's wealth. But by linking its customers to a P\$YCLE segment, a bank can determine whether the individual is a member of *Working-Class USA* (with investable assets likely less than \$25,000) or *Domestic Bliss* (with assets typically above \$100,000). For banks like First Tennessee, such insights are invaluable when representatives talk to customers. "Segmentation lets us know more about customers and their potential even before we talk to them," says Marks. "Based on the customer code, we'll send an upscale customer's name to our private banking service and a more consultative channel. Once you move customers over to a private banking channel, the attrition rate gets cut in half."

Adopting such strategies across multiple departments has allowed First Tennessee to unlock the true power of consumer segmentation. And to increase awareness,

First Tennessee has deployed a successful advertising strategy linked to the media patterns of targeted P\$YCLE segments. While the bank used to run TV commercials on network news and sports programs, P\$YCLE showed that its targeted customers actually preferred cable channels like CNBC, the Weather Channel and the Food Network. The bank's media buy changed accordingly, and the number of new deposit accounts and loan applications rose in response. "We're still surprised by the Food Network," Marks chuckles. "But it's worked very well."

Pitfalls and Principles for Creating Loyal Customers

Despite these success stories, applying consumer segmentation across an enterprise is not always an easy sell. Some sales managers resist focusing on the most valuable customers over the long-term, preferring to acquire as many customers in as short a time as possible—especially if their compensation is structured to reward that objective. Others may consider customer loyalty a qualitative attribute that is less important than such quantitative metrics as product sales. And some ad agencies discredit lifestyle-based segmentation data in favor of their own creative team's intuition, traditional demographics or psychographics to classify customers. At one telecommunications company, agency media buyers persisted in selecting TV shows based on age and gender even after a segmentation analysis revealed that the lifestyles and purchase behavior of the company's most valuable segments were inconsistent with those programs. Only after the target groups were profiled with detailed portraits of their lifestyles and leisure activities—including media preferences—did the ad agency modify its messages, images and media buy for each target group.



For those companies ready to undertake an enterprise-wide segmentation initiative to increase customer loyalty, there are a handful of guiding principles that are important to achieving success:

1. Identify key customer segments.

Using a consumer segmentation system like PRIZM, P\$YCLE or the technology-focused Nielsen ConneXions, append a segment code to each customer address, or use syndicated data if you lack an address file. Identify your best segments by comparing the customers or sales in each segment to the average in your market or nationwide using syndicated data. But keep in mind that determining who your best customers are requires analyzing not just transaction-level profitability, but the cost of maintaining them. Do they use a lot of discount coupons, rain checks or rebates? Do they return a lot of items? These factors play an important role in developing the optimal model.

2. Create target groups of similar segments. After merging similar segments of your best customers into four to eight target groups, analyze each group by who they are (demographics), what they're like (lifestyle activities and product preferences), where they live (geographic concentration) and how to reach them (media consumption). If possible, identify their psychographics to help determine whether they're early adopters, price sensitive or green consumers.

3. Prospect for look-alikes in target markets and your own customer database. Perform a market analysis that projects the concentration of your target groups to potential trade areas, and then rank promising areas by profitability and long-term value. After determining each target group's preferences, develop a media and marketing strategy for each market. Would TV sports programs and country radio make the right connection or are

online job sites and social networks a better choice? One bank based in the South that sponsored NASCAR events was surprised to learn that 70 percent of its core target preferred the opera; it promptly changed its sponsorships.

4. Deliver differentiated messages and experiences. Develop different product positioning or messages for your top target groups to keep current customers from defecting. Also, customize merchandising strategies to the target groups to win greater share of wallet. Each approach should reflect their backgrounds, lifestyles and preferences. And your sales staff should be thoroughly briefed on your top customer groups.

5. Keep it simple. One automaker spent hundreds of thousands of dollars developing its own consumer segmentation system based on a survey of new car buyers and created a model with more than 100 buyer segments. While the system worked well in focus groups, it proved unwieldy in the marketplace, and the manufacturer eventually pulled the plug. Off-the-shelf segmentation systems that provide comprehensive data and actionable strategies let you easily connect with customers on the ground. They're also usually less expensive than more sophisticated, custom models.

6. Get everyone involved in the consumer segmentation approach.

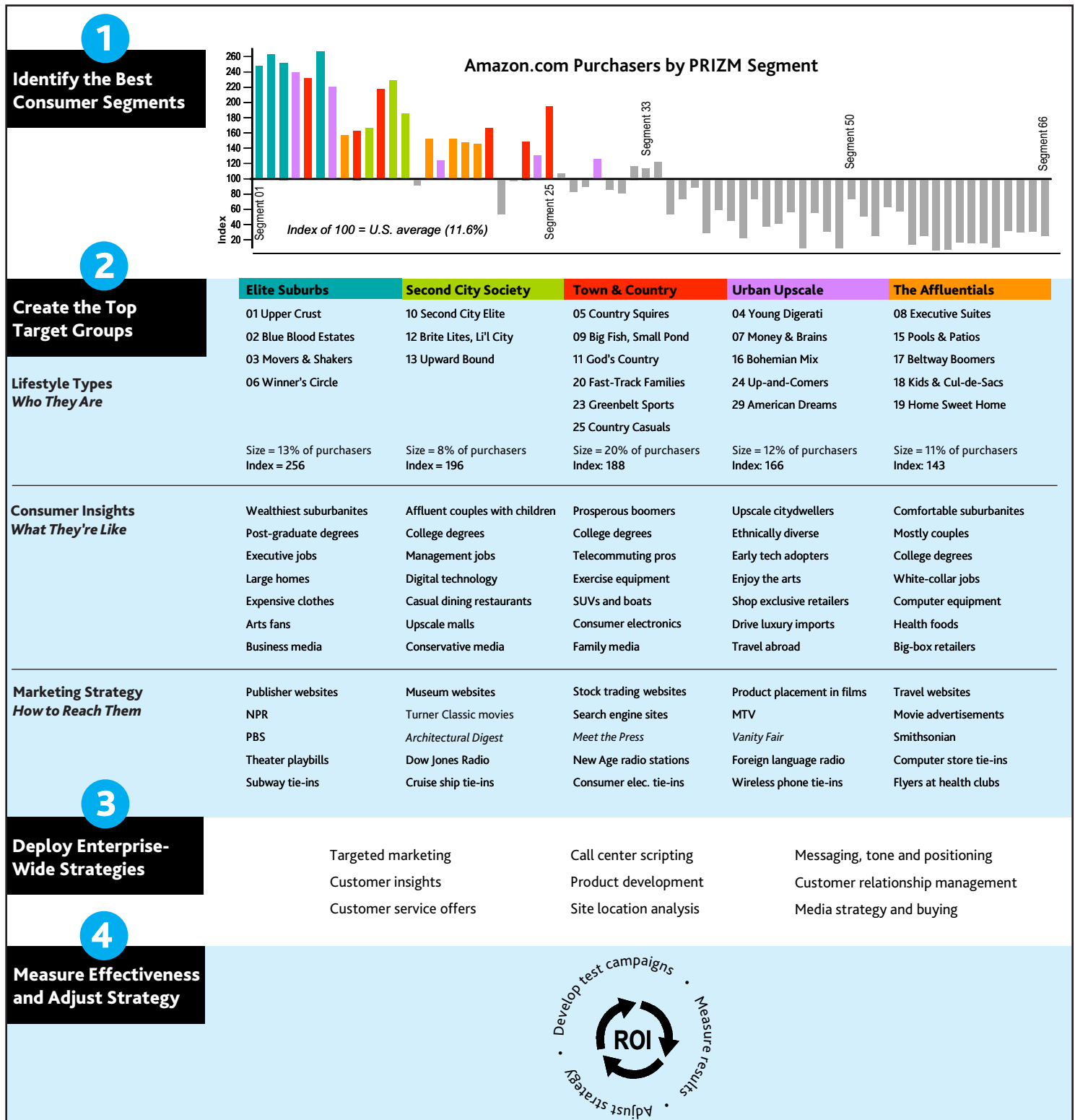
Advanced segmentation initiatives require multiple departments to adopt the strategies. That means that the real estate department no longer selects new store sites based on the lowest lease offered by a mall developer but on the customer segment composition of the area. And it means that a company's merchandising department presents products that appeal to the target audience.

7. Measure the effectiveness and adjust your strategy. Use ROI analytics to ensure your strategy is gaining traction and delivering on goals. By measuring how your customers respond to your efforts, you can better predict their future behavior and refine your segmentation strategies accordingly.

Using consumer segmentation to build customer loyalty can help companies prosper even in a difficult economy with comprehensive data and a willingness to modify practices throughout the enterprise. By shifting resources away from mass marketing channels to a focused campaign that puts their best customers front and center, businesses can improve sales and decrease costs, while building a loyal clientele that allows them to weather this challenging market. And when the economy does turn around, a loyal customer base provides the best platform for future growth.



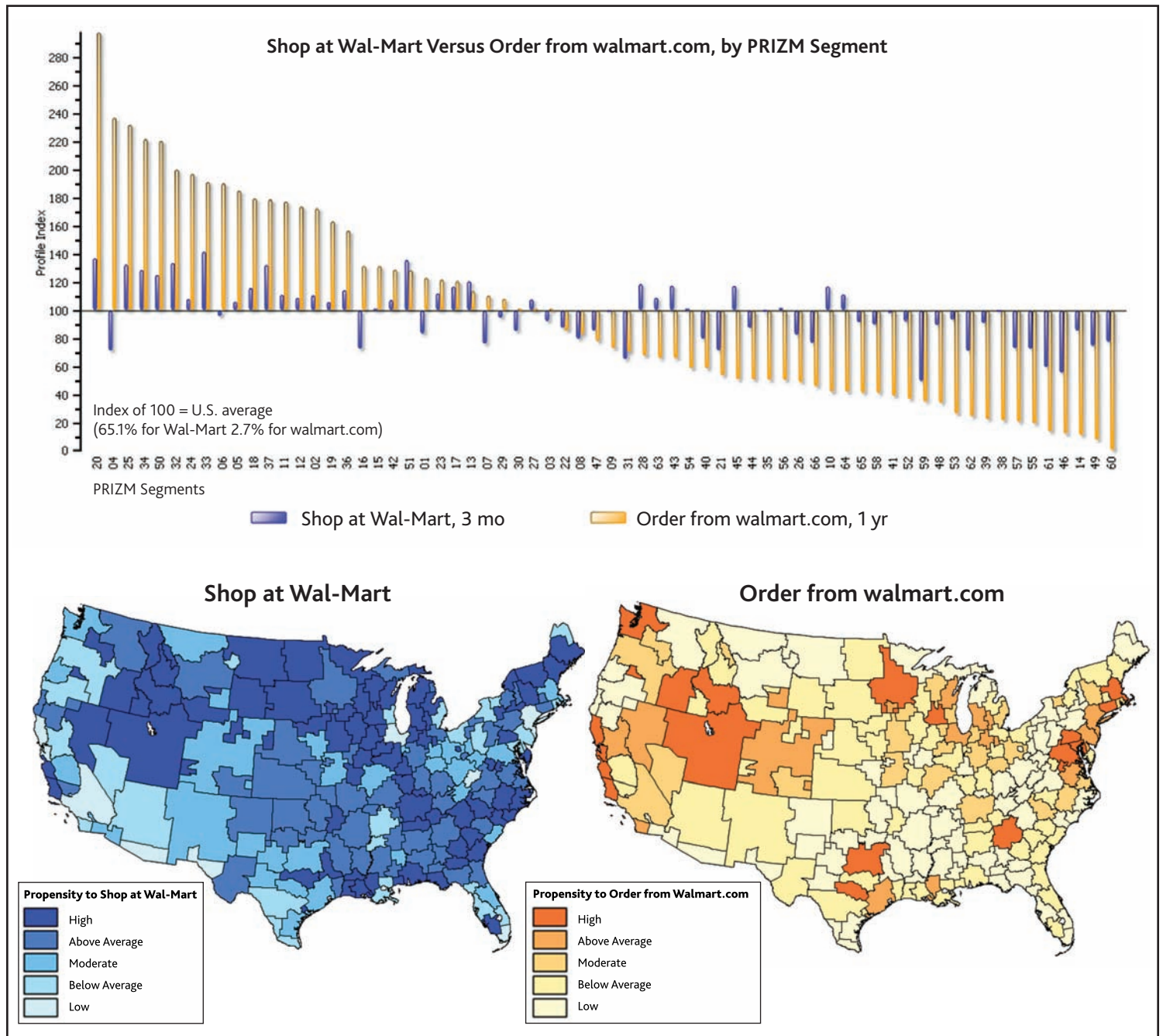
Figure 1: A Framework for Segmentation



In this case study, researchers analyzed Amazon.com's top customers using PRIZM lifestyle-based segments. Analysts grouped high-indexing segments into five target groups, profiled them using media and marketplace surveys and developed differentiated marketing strategies to reach them. The gray bars in the top chart represent low-indexing segments that aren't among Amazon.com's best target groups. The results can be used for strategic and tactical applications across the company.

Sources: Nielsen PRIZM, Mediamark Research & Intelligence.

Figure 2: Segmenting Customers by Channel Yields Different Areas of Opportunity



Consumer segmentation shows that the best customers for a retailer's brick-and-mortar stores may be very different from its best online shoppers. According to the bar chart displaying Nielsen PRIZM segments, Wal-Mart's most loyal fans are found in midscale and working-class exurban segments like New Homesteaders (32) and Big Sky Families (33), and the company should prospect for new customers in the dark blue areas in the map on the left. To expand the customer base for walmart.com, however, the company should focus on younger, metro segments like Young Digerati (04) and Fast-Track Families (20) in the dark orange markets in the right map. And to increase the most loyal customers—who shop at both Wal-Mart and walmart.com—the company should design cross-channel marketing and merchandising initiatives to segments like Mayberry-ville (37) and Shotgun & Pickups (51).

Sources: Nielsen PRIZM, Mediamark Research & Intelligence.

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