

Focusing on the Customer

Consumption is the sole end and purpose of production; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the customer

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Businesses compete to serve customer needs. Not only are there different types of customers, but their needs vary, too. Thus, most markets are not homogeneous. Further, the markets that are homogeneous today may not remain so in the future. In brief, a market represents a dynamic phenomenon that, influenced by customer needs, evolves over time.

In a free economy, each customer group tends to want a slightly different service or product. But a business unit cannot reach out to all customers with equal effectiveness; it must distinguish easily accessible customer groups from hard-to-reach customer groups. Moreover, a business unit faces competitors whose ability to respond to customer needs and cover customer groups differs from its own. To establish a strategic edge over its competition with a viable marketing strategy, it is important for the business unit to clearly define the market it intends to serve. It must segment the market, identifying one or more subsets of customers within the total market, and concentrate its efforts on meeting their needs. Fine targeting of the customer group to serve offers the opportunity to establish competitive leverage.

This chapter introduces a framework for identifying markets to serve. Various underlying concepts of market definition are examined. The chapter ends with a discussion of alternative ways of segmenting a market.

IDENTIFYING MARKETS

Contemporary approaches to strategic planning require proper definition of the market; however, questions about how to properly characterize a market make it difficult to arrive at an acceptable definition. Depending on how the market is defined, the relative market positions of two companies and their two products can be reversed, as shown in the following table.

| <i>Percentage Market Share</i> | | |
|--------------------------------|---------------------------|------------------|
| <i>Brands</i> | <i>Unsegmented (Mass)</i> | <i>Segmented</i> |
| S | 32 | 40 |
| T | 24 | 30 |
| U | 16 | 20 |
| V | 8 | 10 |
| X | 12 | 60 |
| Y | 6 | 30 |
| Z | 2 | 10 |

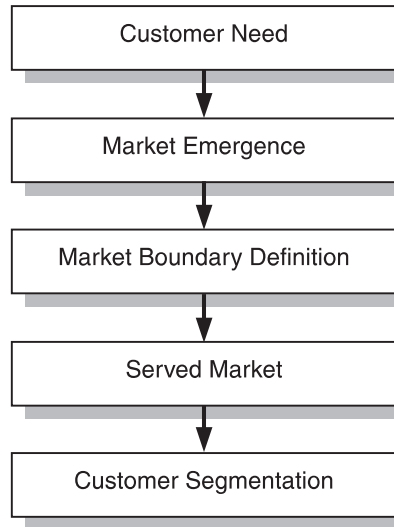
Though brand X has a low share in the unsegmented, or mass, market (12 percent), it has a much higher share within its own segment of the mass market (60 percent) than does brand S (40 percent). Which of the two shares shown is better for the business: the total mass market for the product category or some segmented portion of that market? The arguments go both ways, some pointing out the merits of having a larger share of industry volume and others noting the favorable profit consequences of holding a larger share within a smaller market niche. Does Sanka compete in the total mass market for coffee with Maxwell House and Folgers or in a decaffeinated market segment against Brim and Nescafe? Does the market for personal computers include intelligent and dumb terminals as well as word processors, desktop and laptop computers, and intelligent telephones? Grape Nuts has 100 percent of the Grape Nuts market, a smaller percentage of the breakfast cereal market, an even smaller percentage of the packaged-foods market, a still smaller percentage of the packaged-goods market, a tiny percentage of the U.S. food market, a minuscule percentage of the world food market, and a microscopic percentage of total consumer expenditures. All descriptions of market share are meaningless, however, unless a company defines the market in terms of the boundaries separating it from its rivals.

Considering the importance of adequately defining the market, it is desirable to systematically develop a conceptual framework for that purpose. Exhibit 5-1 presents such a framework.

The first logical step in defining the market is to determine customer need. Based on need, the market emerges. Because customer need provides a broad perspective of the market, it is desirable to establish market boundaries. Traditionally, market boundaries have been defined in terms of product/market scope, but recent work suggests that markets should be defined multidimensionally.

The market boundary delineates the total limits of the market. An individual business must select and serve those parts, or segments, of the total market in which it is best equipped to compete over the long run. Consider Polaroid. It started as an instant photography firm. As such, it had only a 7 percent stake in the \$15 billion photography industry. Over the years, it carried out a multi-billion dollar market for itself. But in the 1990s, the company realized it had little chance of any further growth. The developed world was already saturated with cameras, and photography itself was beginning to lose out to home videomaking. By aiming

EXHIBIT 5-1
Identifying Markets to Serve



instead at the entire imaging industry—from photocopying to printing and video as well as photography—Polaroid saw a chance to compete in a rapidly growing, \$150 billion global business.¹

CUSTOMER NEED

Satisfaction of customer need is the ultimate test of a business unit's success. Thus, an effective marketing strategy should aim at serving customer needs and wants better than competitors do. Focus on customers is the essence of marketing strategy. As Robertson and Wind have said:

Marketing performs a boundary role function between the company and its markets. It guides the allocation of resources to product and service offerings designed to satisfy market needs while achieving corporate objectives. This boundary role function of marketing is critical to strategy development. Before marshaling a company's resources to acquire a new business, or to introduce a new product, or to reposition an existing product, management must use marketing research to cross the company-consumer boundary and to assess the likely market response.

The logic and value of consumer needs assessment is generally beyond dispute, yet frequently ignored. It is estimated, for example, that a majority of new products fail. Yet, there is most often nothing wrong with the product itself; that is, it works. The problem is simply that consumers do not want the product.

AT&T's Picture Phone is a classic example of a technology-driven product that works; but people do not want to see each other on a telephone. It transforms a comfortable, low involvement communication transaction into a demanding, high

involvement one. The benefit is not obvious to consumers. Of course, the benefit could become obvious if transportation costs continue to outpace communication costs, and if consumers could be “taught” the benefits of using a Picture Phone.

Marketing’s boundary role function is similarly important in maintaining a viable competitive positioning in the marketplace. The passing of Korvette from the American retail scene, for example, can be attributed to consumer confusion as to what Korvette represented—how it was positioned relative to competition. Korvette’s strength was as a discount chain—high turnover and low margin. This basic mission of the business was violated, however, as Korvette traded-up in soft goods and fashion items and even opened a store on Manhattan’s Fifth Avenue. The result was that Korvette became neither a discount store nor a department store and lost its previous customer base. Sears has encountered a similar phenomenon as it opted for higher margins in the 1970s and lost its reputation for “value” in the marketplace. The penalty has been declining sales and profitability for its retail store operation, which it is now trying valiantly to arrest by reestablishing its “middle America” value orientation. Nevertheless, consumer research could have indicated the beginning of the problem long before the crisis in sales and profits occurred.²

Concept of Need

Customer need has always formed the basis of sound marketing. Yet, as Ohmae points out, it is often neglected or ignored:

Think for a moment about aching heads. Is my headache the same as yours? My cold? My shoulder pain? My stomach discomfort? Of course not. Yet when a pharmaceutical company asked for help . . . [it] asked 50 employees in the company to fill out a questionnaire—throughout a full year—about how they felt physically at all times of the day every day of the year. Then [it] pulled together a list of the symptoms described, sat down with the company’s scientists, and asked them, item by item: Do you know why people feel this way? Do you have a drug for this kind of symptom? It turned out that there were no drugs for about 80 percent of the symptoms, these physical awarenesses of discomfort. For many of them, some combination of existing drugs worked just fine. For others, no one had ever thought to seek a particular remedy. The scientists were ignoring tons of profit.

Without understanding customers’ needs—the specific types of discomfort they were feeling—the company found it all too easy to say, “Headache? Fine, here’s a medicine, an aspirin, for headache. Case closed.” It was easy not to take the next step and ask, “What does the headache feel like? Where does it come from? What is the underlying cause? How can we treat the cause, not just the symptom?” Many of these symptoms, for example, are psychological and culture-specific. Just look at television commercials. In the United States, the most common complaint is headache; in the United Kingdom, backache; in Japan, stomach ache. In the United States, people say that they have a splitting headache; in Japan it is an ulcer. How can we truly understand what these people are feeling and why?³

Looking closely at needs is the first step in delivering value to customers. Traditionally, needs have been classified according to Maslow’s hierarchy of human needs. From lowest to highest, Maslow’s hierarchy identifies five levels of needs: physiological, safety, belongingness, self-esteem, and self-actualization. Needs at each level of the hierarchy can be satisfied only after needs at the levels below it have been satisfied. A need unsatisfied becomes a source of frustration.

When the frustration is sufficiently intense, it motivates a relief action—the purchase of a product, for example. Once a need is satisfied, it is forgotten, creating space for the awareness of other needs. In a marketing context, this suggests that customers need periodic reminders of their association with a product, particularly when satisfied.

Business strategy can be based on the certainty that needs exist. As we move up Maslow's hierarchy, needs become less and less obvious. The challenge in marketing is to expose nonobvious needs, to fill needs at all levels of the hierarchy.

Maslow's first two levels can be called survival levels. Most businesses operate at Level 2 (safety), with occasional spikes into higher levels. A business must satisfy a safety need to have a viable operation. The customer must feel both physically and economically safe in buying the product. The next higher levels—belongingness and self-esteem—are customer reward levels, where benefits of consuming a product accrue to the customer personally, enhancing his or her sense of worth. At the highest level, self-actualization, the customer feels a close identification with the product. Of course, not all needs can be filled, nor would it be economically feasible to attempt to do so. But a business can move further toward satisfaction of customer needs by utilizing the insights of the Maslow hierarchy.

MARKET EMERGENCE

Customer need gives rise to a market opportunity, and a market emerges. To judge the worth of this market, an estimate of market potential is important. If the market appears attractive, the strategist takes the next step of delineating the market boundary. This section examines the potential of the market.

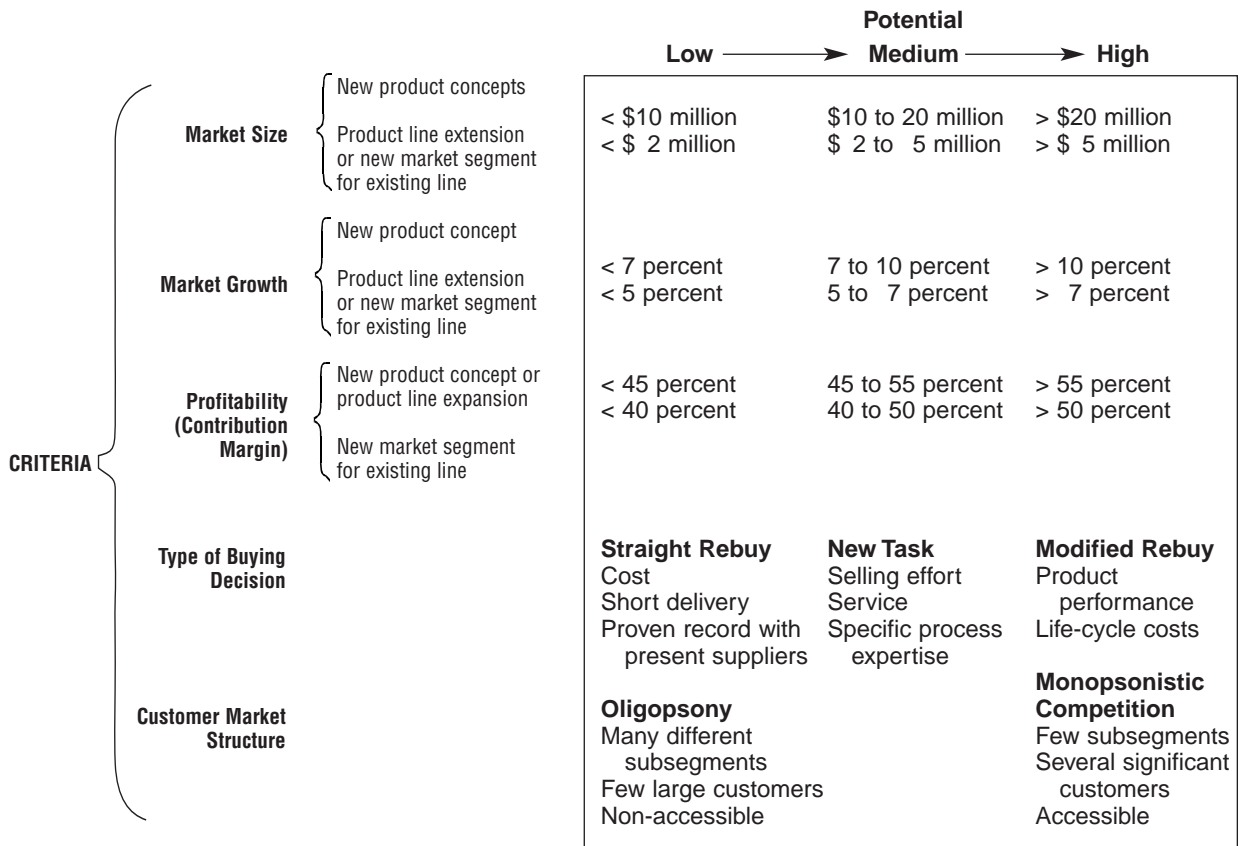
Simply stated, **market potential** is the total demand for a product in a given environment. Market potential is measured to gain insights into five elements: market size, market growth, profitability, type of buying decision, and customer market structure. Exhibit 5-2 summarizes these elements and shows a pro forma scheme for measuring market potential.

The first element, *market size*, is best expressed in both units and dollars. Dollar expression in isolation is inadequate because of distortion by inflation and international currency fluctuations. Also, because of inflationary distortion, the screening criteria for new product concepts and product line extensions should separately specify both units and dollars. Market size can be expressed as total market sales potential or company market share, although most companies through custom utilize market share figures.

The second element, *market growth*, is meant to reflect the secular trend of the industry. Again, the screening criteria should be specified for new product concepts and product line extensions. The criteria and projections should be based on percentage growth in units. Projections in industrial settings often are heavily dependent on retrofit possibilities and plans for equipment replacement.

The third element in this evaluation of strategic potential is *profitability*. It usually is expressed in terms of contribution margin or in one of the family of

EXHIBIT 5-2
Measurement of Market Potential



| Criteria | Low | Medium | High | Data Source | Comments/Additional Data Needed |
|---------------------------|-----|--------|------|-------------|---------------------------------|
| Market | | | | | |
| Market Growth | | | | | |
| Profitability | | | | | |
| Type of Buying Decision | | | | | |
| Customer Market Structure | | | | | |
| Overall Rating | | | | | |

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return calculations. Most U.S. companies view profitability in terms of return on investment (ROI), return on sales (ROS), or return on net assets (RONA). Return on capital employed (ROCE) is often calculated in multinational companies. For measuring market potential, no one of these calculations appears to function better than another.

The fourth element is the *type of buying decision*. The basis for a buying decision must be predicated on whether the decision is a straight rebuy, a modified rebuy, or a new task.

The fifth and final element is the *customer market structure*. Based on the same criteria as competitive structure, the market can be classified as monopsony, oligopsony, differentiated competition (monopsonistic competition), or pure competition.

DEFINING MARKET BOUNDARIES

The crux of any strategy formulation effort is market definition:

The problem of identifying competitive product-market boundaries pervades all levels of marketing decisions. Such strategic issues as the basic definition of a business, the assessment of opportunities presented by gaps in the market, the reaction to threats posed by competitive actions, and the decisions on major resource allocations are strongly influenced by the breadth or narrowness of the definition of competitive boundaries. The importance of share of market for evaluating performance and for guiding territorial advertising, sales force, and other budget allocations and the growing number of antitrust prosecutions also call for defensible definitions of product-market boundaries.⁴

Defining the market is difficult, however, since market can be defined in many ways. Consider the cooking appliance business. Overall in 1997 about 18 million gas and electric ranges and microwave ovens were sold for household use. All these appliances serve the basic function of cooking, but their similarity ends there. They differ in many ways: (a) with reference to fuels—primarily gas versus electricity; (b) in cooking method—heat versus radiation; (c) with reference to type of cooking function—surface heating, baking, roasting, broiling, etc.; (d) in design—freestanding ranges, built-in countertop ranges, wall ovens, counter-top microwave ovens, combinations of microwave units, and conventional ranges, etc.; and (e) in price and product features.

These differences raise an important question: Should all household cooking appliances be considered a single market or do they represent several distinct markets? If they represent several distinct markets, how should these markets be defined? There are different possibilities for defining the market: (a) with reference to product characteristics; (b) in terms of private brand sales versus manufacturers' brand sales; (c) with reference to sales in specific regions; and (d) in terms of sales target, for example, sales to building contractors for installation in new houses versus replacement sales for existing homes.

Depending on the criteria adopted to define the market, the size of a market varies considerably. The strategic question of how the marketer of home cooking appliances should define the market is explored below.

Dimensions of Market Boundaries

Traditionally, market boundaries have been defined in terms of product/market space. Consider the following:

A market is sometimes defined as a group of firms producing identical or closely related products. . . . A preferable approach is to define the markets in terms of products. . . . [What is meant by] a close relationship among products? Goods and services may be closely related in the sense that they are regarded as substitutes by consumers, or they may be close in that the factors of production used in each are similar.⁵

Some identify a market with a generic class of products. One hears of the beer market, the cake mix market, or the cigarette market. According to others, product markets refer to individuals who have purchased a given class of products.

These two definitions of the market—the market as a class of closely related products versus the market as a class of people who purchase a certain kind of product—view it from one of two perspectives: who are the buyers and what are the products. In the first definition, buyers are implicitly assumed to be homogeneous in their behavior. The second definition suggests that the products and brands within a category are easily identified and interchangeable and that the problem is to search for market segments.

In recent years, it has been considered inadequate to perceive market definition as simply a choice of products for chosen markets. Instead, the product may be considered a physical manifestation of a particular technology to a particular customer function for a particular customer group. Market boundaries should then be determined by choices along these three dimensions.⁶

Technology. A particular customer function can be performed by different technologies. In other words, alternative technologies can be applied to satisfy a particular customer need. To illustrate, consider home cooking appliances again. In terms of fuel, the traditional alternative technologies have been gas and electricity. In recent years, a new form of technology, microwave radiation, has also been used. In another industry, alternative technologies may be based on the use of different materials. For example, containers may be made from metal, glass, or plastic. In defining market boundaries, a decision must be made whether the products of all relevant technologies or only those of a particular technology are to be included.

Customer Function. Products can be considered in terms of the functions they serve or in terms of the ways in which they are used. Some cooking appliances bake and roast, others fry and boil; some perform all these functions and perhaps more. Different functions provide varying customer benefits. In establishing market boundaries, customer benefits to be served should be spelled out.

Customer Group. A group refers to a homogeneous set of customers with similar needs and characteristics. The market for cooking appliances, for example, can be split into different groups: building contractors, individual households buying through retail stores, and so on. The retail stores segment can be further broken down into traditional appliance specialty stores, mass merchandisers, and so on.

Decisions about market boundaries should indicate which types of customers are to be served.

In addition to these three dimensions for determining market boundaries, Buzzell recommends a fourth—level of production/distribution.⁷ A business has the option of operating at one or more levels of the production/distribution process. For example, producers of raw materials (e.g., aluminum) or component products (e.g., semiconductors, motors, compressors) may limit their business to selling only to other producers, they may produce finished products themselves, or they may do both. Decisions about production/distribution levels have a direct impact on the market boundary definition. This point may be illustrated with reference to Texas Instruments:

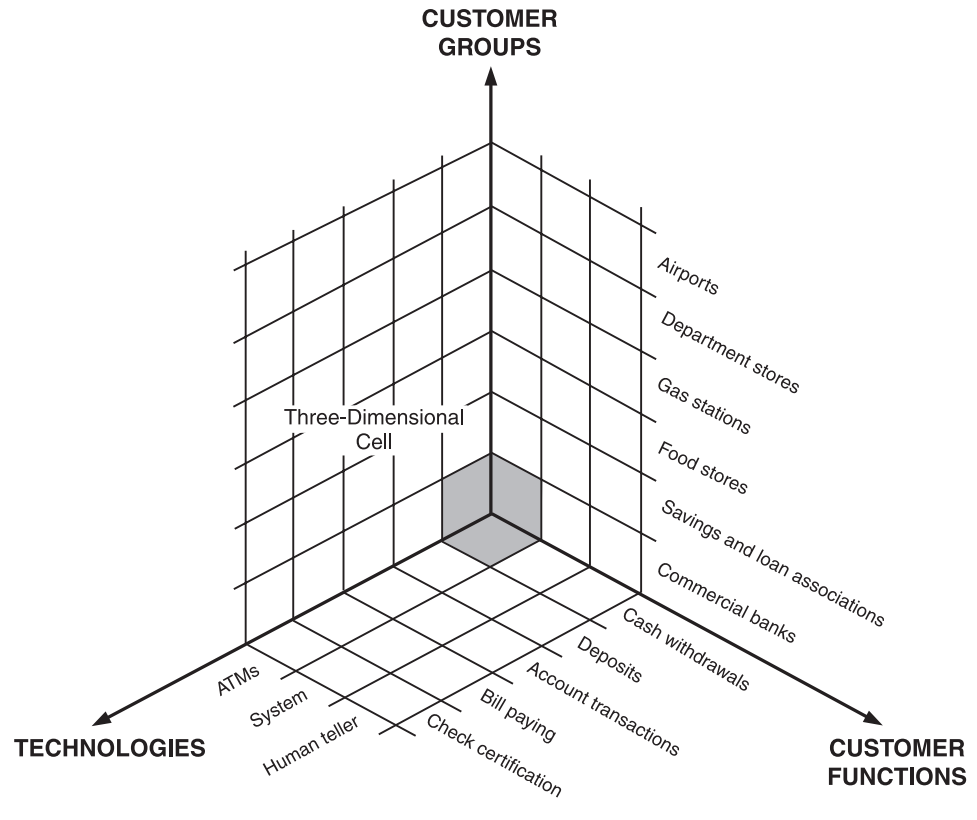
The impact that a business unit's vertical integration strategy can have on competition in a market is dramatically illustrated by Texas Instruments' decision, in 1972, to enter the calculator business. At the time, it was a principal supplier of calculator components (integrated circuits) to the earlier entrants into the market, including the initial market leader, Bowmar Instruments. As most readers undoubtedly know, TI quickly took over a leadership position in calculators through a combination of "pricing down the experience curve" and aggressive promotion. For purposes of this discussion, the important point is one of a finished product. Some other component suppliers also entered the calculator business, while others continued to supply OEMs. In light of these varying strategies, is there a "calculator component market" and "calculator market," or do these constitute a single market?⁸

Exhibit 5-3 depicts the three dimensions of the market boundary definition from the viewpoint of the personal financial transactions industry. Market boundaries are defined in terms of customer groups, customer functions, and technologies. The fourth dimension, level of production/distribution, is not included in the diagram because it is not possible to show four dimensions in a single chart. The exhibit shows a matrix developed around customer groups on the vertical axis, customer functions on the right axis, and technologies on the left axis. Any three-dimensional cell in the matrix constitutes an elementary "building block" of market definition. An automatic teller machine (ATM) for cash withdrawals at a commercial bank is an example of such a cell.

Redefining Market Boundaries

As markets evolve, boundaries may need to be restated. Five sets of "environmental influences" affect product/market boundaries. These influences are technological change (displacement by a new technology); market-oriented product development (e.g., combining the features of several products into one multipurpose offering); price changes and supply constraints (which influence the perceived set of substitutes); social, legal, or government trends (which influence patterns of competition); and international trade competition (which changes geographic boundaries).⁹ For example, when management introduces a new product, markets an existing product to new customers, diversifies the business through acquisition, or liquidates a part of the business, the market undergoes a process of evolution. Redefinition of market boundaries may be based on any one or a combination of the three basic dimensions. The market may be extended

EXHIBIT 5-3
Dimensions of Market Boundary Definition for Personal Financial Transactions

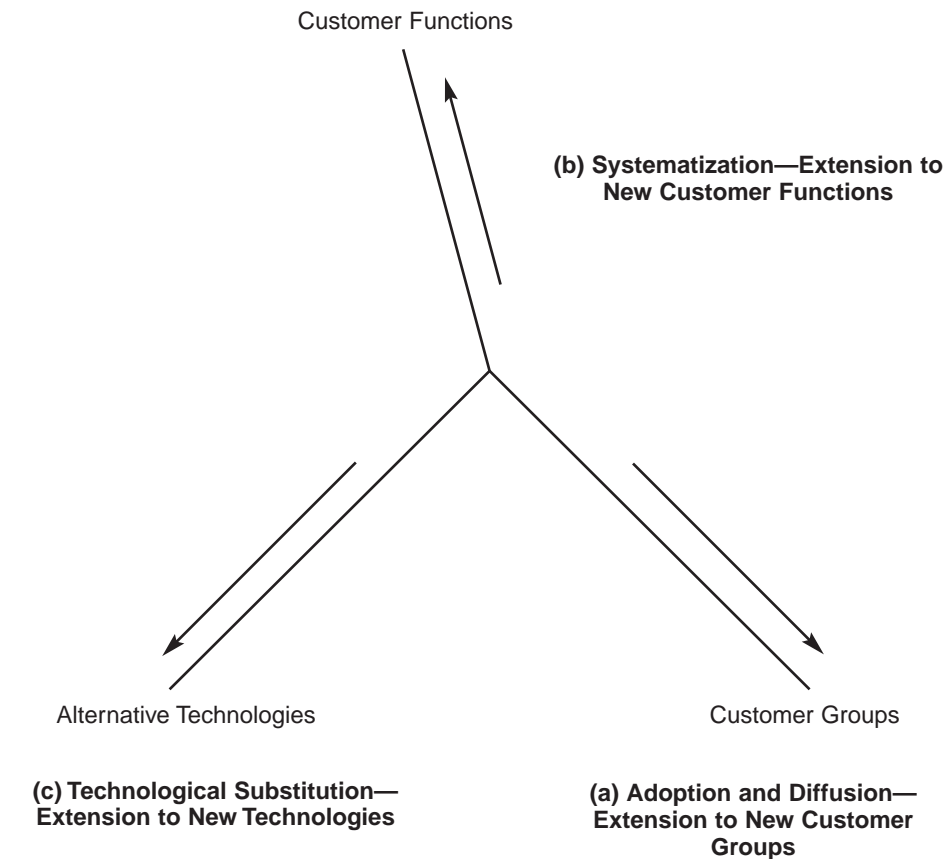


through the penetration of new customer groups, the addition of products serving related customer functions, or the development of products based on new technologies. As shown in Exhibit 5-4, these changes are caused by three fundamentally different phenomena: The adoption and diffusion process underlies the penetration of new customer groups, a process of systemization results in the operation of products to serve combinations of functions, and the technology substitution process underlies change on a technology dimension.

SERVED MARKET

Earlier in this chapter, it was concluded that the task of market boundary definition amounts to grouping together a set of market cells (see Exhibit 5-3), each defined in terms of three dimensions: customer groups, customer functions, and technologies. In other words, a market may comprise any combination of these

EXHIBIT 5-4
Market Evolution in Three Dimensions



Source: Derek F. Abell, *Defining the Business: The Starting Point of Strategic Planning*, © 1980, p. 207. Reprinted by permission of Prentice-Hall, Inc., Englewood Cliffs, N.J.

cells. An additional question must now be answered. Should a business unit serve the entire market or limit itself to serving just a part of it? While it is conceivable that a business unit may decide to serve the total market, usually the served market is considerably narrower in scope and smaller in size than the total market. The decision about what market to serve is based on such factors as the following:

1. Perceptions of which product function and technology groupings can best be protected and dominated.
2. Internal resource limitations that force a narrow focus.
3. Cumulative trial-and-error experience in reacting to threats and opportunities.

4. Unusual competencies stemming from access to scarce resources or protected markets.¹⁰

In practice, the choice of served market is not based on conscious, deliberate effort. Rather, circumstances and perceptions surrounding the business unit dictate the decision. For some businesses, lack of adequate resources limits the range of possibilities. Dell Computer, for example, would be naive to consider competing against IBM across the board. Further, as a business unit gains experience through trial and error, it may extend the scope of its served market. For example, the U.S. Post Office entered the overnight package delivery market to participate in an opportunity established by the Federal Express Company. The task of delineating the served market, however, is full of complications. As Day has noted:

In practice, the task of grouping market cells to define a market is complicated. First, there is usually no one defensible criterion for grouping cells. There may be many ways to achieve the same function. Thus, boxed chocolates compete to some degree with flowers, records, and books as semicasual gifts. Do all of these products belong in the total market? To confound this problem, the available statistical and accounting data are often aggregated to a level where important distinctions between cells are completely obscured. Second, there are many products which evolve by adding new combinations of functions and technologies. Thus, radios are multifunctional products which include clocks, alarms, appearance options. To what extent do these variants dictate new market cells? Third, different competitors may choose different combinations of market cells to serve or to include in their total market definitions. In these situations there will be few direct competitors; instead, businesses will encounter each other in different but overlapping markets, and, as a result, may employ different strategies.¹¹

Strategically, the choice of a business unit's served market may be based on the following approaches:

- I. Breadth of Product Line

- A. Specialized in terms of technology, broad range of product uses
- B. Specialized in terms of product uses, multiple technologies
- C. Specialized in a single technology, narrow range of product uses
- D. Broad range of (related) technologies and uses
- E. Broad versus narrow range of quality/price levels

- II. Types of Customers

- A. Single customer segment
- B. Multiple customer segments
 1. Undifferentiated treatment
 2. Differentiated treatment

- III. Geographic Scope

- A. Local or regional
- B. National
- C. Multinational

IV. Level of Production/Distribution

- A. Raw or semifinished materials or components
- B. Finished products
- C. Wholesale or retail distribution

An Example of a Served Market

The choice of served market may be illustrated with reference to one company's entry into the snowmobile business. The management of this company considered snowmobiles an attractive market in terms of sales potential. The boundaries of this market are extensive. For example, in terms of technology, a snowmobile may be powered by gas, diesel fuel, or electricity. A snowmobile may fulfill such customer functions as delivery, recreation, and emergency transportation. Customer groups include household consumers, industrial buyers, and the military.

Since the company could not cover the total market, it had to define the market it would serve. To accomplish this task, the company developed a product/market matrix (see Exhibit 5-5a). The company could use any technology—gasoline, diesel, or electric—and it could design a snowmobile for any one of three customer groups: consumer, industrial, or military. The matrix in Exhibit 5-5a furnished nine possibilities for the company. Considering market potential and its competencies to compete, the part of the market that looked best was the diesel-powered snowmobile for the industrial market segment, the shaded area in Exhibit 5-5a.

But further narrowing of the market to be served was necessary. A second matrix (see Exhibit 5-5b) laid out the dimensions of customer use (function) and customer size. Thus, as shown in Exhibit 5-5b, snowmobiles could be designed for use as delivery vehicles (e.g., used by business firms and the post office), as recreation vehicles (e.g., rented at resort hotel sites), or as emergency vehicles (e.g., used by hospitals and police forces). Further, the design of the snowmobile would be affected by whether the company would sell to large, medium, or small customers. After evaluating the nine alternatives in Exhibit 5-5b, the company found the large customer, delivery use market attractive, defining its served market as diesel-driven snowmobiles for use as delivery vehicles by large industrial customers.

Served Market Alternatives

In the preceding example, the company settled on a rather narrow definition of the served market. It could, however, expand the scope of the served market as it gains experience and as opportunities elsewhere in the market appear attractive. The following is a summary of the served market alternatives available to a business similar to this one.

1. Product/market concentration consists of the company's niching itself in only one part of the market. In the above example, the company's niche was making only diesel-driven snowmobiles for industrial buyers.
2. Product specialization consists of the company's deciding to produce only diesel-driven snowmobiles for all customer groups.

EXHIBIT 5-5
Defined the Served Market

| | | Market | | |
|------------|-----------------------------|----------|------------|----------|
| | | Consumer | Industrial | Military |
| Technology | Gas-driven snowmobiles | | | |
| | Diesel-driven snowmobiles | | | |
| | Electric-driven snowmobiles | | | |

(a) Technology/Market Matrix

| | | Customer Use | | |
|---------------|--------|--------------|------------|-----------|
| | | Delivery | Recreation | Emergency |
| Customer Size | Large | | | |
| | Medium | | | |
| | Small | | | |

(b) Customer Size/Customer Use Matrix

Source: Philip Kotler, "Strategic Planning and the Marketing Process," *Business* (May-June 1980): 6-7. Reprinted by permission of the author.

3. Market specialization consists of the company's deciding to make a variety of snowmobiles that serve the varied needs of a particular customer group, such as industrial buyers.
4. Selective specialization consists of the company's entering several product markets that have no relation to each other except that each provides an individually attractive opportunity.
5. Full coverage consists of the company's making a full range of snowmobiles to serve all market segments.

CUSTOMER SEGMENTATION

In the snowmobile example, the served market consisted of one segment. But conceivably, the served market could be much broader in scope. For example, the company could decide to serve all industrial customers (large, medium, small) by offering diesel-driven snowmobiles for delivery use. The "broader" served market, however, must be segmented because the market is not homogeneous; that is, it cannot be served by one type of product/service offering.

Currently, the United States represents the largest market in the world for most products; it is not a homogeneous market, however. Not all customers want the same thing. Particularly in well-supplied markets, customers generally prefer products or services that are tailored to their needs. Differences can be expressed in terms of product or service features, service levels, quality levels, or something else. In other words, the large market has a variety of submarkets, or segments, that vary substantially. One of the crucial elements of marketing strategy is to choose the segment or segments that are to be served. This, however, is not always easy because different methods for dissecting a market may be employed and deciding which method to use may pose a problem.

Virtually all strategists segment their markets. Typically, they use SIC codes, annual purchase volume, age, and income as differentiating variables. Categories based on these variables, however, may not suffice as far as the development of strategy is concerned.

RCA, for example, initially classified potential customers for color television sets according to age, income, and social class. The company soon realized that these segments were not crucial for continued growth because potential buyers were not confined to those groups. Later analysis discovered that there were "innovators" and "followers" in each of the above groups. This finding led the company to tailor its marketing strategy to various segments according to their "innovativeness." Mass acceptance of color television might have been delayed substantially if RCA had followed a more traditional approach.

An American food processor achieved rapid success in the French market after discovering that "modern" Frenchwomen liked processed foods while "traditional" French housewives looked upon them as a threat. A leading industrial manufacturer discovered that its critical variable was the amount of annual usage per item, not per order or per any other conventional variable. This proved to be critical since heavy users can be expected to be more sensitive to price and may be more aware of and responsive to promotional perspectives.

Segmentation aims at increasing the scope of business by closely aligning a product or brand with an identifiable customer group. Take, for example, cigarettes. Thirty years ago, most cigarette smokers chose from among three brands: Camel, Chesterfield, and Lucky Strike. Today more than 160 brands adorn retail shelves. In order to sell more cigarettes, tobacco companies have been dividing the smoking public into relatively tiny sociological groups and then aiming one or more brands at each group. Vantage and Merit, for example, are aimed at young women; Camel and Winston are aimed mostly at rural smokers. Cigarette marketing success hinges on how effectively a company can design a brand to appeal to a particular type of smoker and then on how well it can reach that smoker with sharply focused packaging, product design, and advertising.

What is true of cigarettes applies to many, many products; it applies even to services. Banks, for example, have been vying with one another for important customers by offering innovative services that set each bank apart from its competition.

These illustrations underscore not only the significance of segmenting the market but also the importance of carefully choosing segmentation criteria.

Segmentation Criteria

Segmentation criteria vary depending on the nature of the market. In consumer-goods marketing, one may use simple demographic and socioeconomic variables, personality and lifestyle variables, or situation-specific events (such as use intensity, brand loyalty, and attitudes) as the bases of segmentation. In industrial marketing, segmentation is achieved by forming end use segments, product segments, geographic segments, common buying factor segments, and customer size segments. Exhibit 5-6 provides an inventory of different bases for segmentation. Most of these bases are self-explanatory. For a detailed account, however, reference may be made to a textbook on marketing management.

In addition to these criteria, creative analysts may well identify others. For example, a shipbuilding company dissects its tanker market into large, medium, and small markets; similarly, its cargo ship market is classified into high-, medium-, and low-grade markets. A forklift manufacturer divides its market on the basis of product performance requirements. Many consumer-goods companies, General Foods, Procter & Gamble, and Coca-Cola among them, base their segments on lifestyle analysis.

Data for forming customer segments may be analyzed with the use of simple statistical techniques (e.g., averages) or multivariate methods. Conceptually, the following procedure may be adopted to choose a criterion for segmentation:

1. Identify potential customers and the nature of their needs.
2. Segment all customers into groups having
 - a. Common requirements.
 - b. The same value system with respect to the importance of these requirements.
3. Determine the theoretically most efficient means of serving each market segment, making sure that the distribution system selected differentiates each segment with respect to cost and price.

EXHIBIT 5-6
Basis for Customer Segmentation

A. *Consumer Markets*

1. Demographic factors (age, income, sex, etc.)
2. Socioeconomic factors (social class, stage in the family life cycle)
3. Geographic factors
4. Psychological factors (lifestyle, personality traits)
5. Consumption patterns (heavy, moderate, and light users)
6. Perceptual factors (benefit segmentation, perceptual mapping)
7. Brand loyalty patterns

B. *Industrial Markets*

1. End use segments (identified by SIC code)
 2. Product segments (based on technological differences or production economics)
 3. Geographic segments (defined by boundaries between countries or by regional differences within them)
 4. Common buying factor segments (cut across product/market and geographic segments)
 5. Customer size segments
-

4. Adjust this ideal system to the constraints of the real world: existing commitments, legal restrictions, practicality, and so forth.

A market can also be segmented by level of customer service, stage of production, price/performance characteristics, credit arrangements with customers, location of plants, characteristics of manufacturing equipment, channels of distribution, and financial policies. The key is to choose a variable or variables that so divide the market that customers in a segment respond similarly to some aspect of the marketer's strategy.¹² The variable should be measurable; that is, it should represent an objective value, such as income, rate of consumption, or frequency of buying, not simply a qualitative viewpoint, such as the degree of customer happiness. Also, the variable should create segments that may be accessible through promotion. Even if it is feasible to measure happiness, segments based on the happiness variable cannot be reached by a specific promotional medium. Finally, segments should be substantial in size; that is, they should be sufficiently large to warrant a separate marketing effort.

Once segments have been formed, the next strategic issue is deciding which segment should be selected. The selected segment should comply with the following conditions:

1. It should be one in which the maximum differential in competitive strategy can be developed.
2. It must be capable of being isolated so that competitive advantage can be preserved.
3. It must be valid even though imitated.

The success of Volkswagen in the United States in 1960 can be attributed to its fit into a market segment that had two unique characteristics. First, the segment served by VW could not be adequately served by a modification to conventional U.S. cars. Second, U.S. manufacturers' economies of scale could not be brought to bear to the disadvantage of VW. In contrast, American Motors was equally successful in identifying a special segment to serve with its compact car, the Rambler. The critical difference was that American Motors could not protect that segment from the superior scale of manufacturing volume of the other three U.S. automobile producers.

The choice of strategically critical segments is not straightforward. It requires careful evaluation of business strengths as compared with the competition. It also requires analytical marketing research to uncover market segments in which these competitive strengths can be significant.¹³



Rarely do market segments conveniently coincide with such obvious categories as religion, age, profession, or family income; or, in the industrial sector, with the size of company. For this reason, market segmentation is emphatically not a job for statisticians. Rather, it is a task that can be mastered only by the creative strategist. For example, an industrial company found that the key to segmenting customers is by the phase of the purchase decision process that they experienced. Accordingly, three segments were identified: (a) first-time prospects, (b) novices, and (c) sophisticates.¹⁴ These three segments valued different benefits, bought from different channels, and carried varying impressions of providers.

A technology-consulting firm, Forrester Research Inc., separates people into ten categories: "fast forwards, techno-strivers, hand-shakers, new age nurturers, digital hopefuls, traditionalists, mouse potatoes, gadget-grabbers, media junkies, and sidelined citizens." Exhibit 5-7 defines each group. For example, "Fast forwards" own on an average 20 technology products per household. Several of their clients have found this kind of classification useful in identifying segments to serve.¹⁵

Market segmentation has recently undergone several changes. These include: ¹⁶

- Increased emphasis on segmentation criteria that represent "softer" data such as attitudes and needs. This is the case in both consumer and business-to-business marketing.
- Increased awareness that the bases of segmentation depend on its purpose. For example, the same bank customers could be segmented by account ownership profiles, attitudes towards risk-taking, and socioeconomic variables. Each segmentation could be useful for a different purpose, such as product cross-selling, preparation of advertising messages, and media selection.
- A move towards "letting the data speak for themselves," that is finding segments through the detection of patterns in survey or in-house data. So-called "data mining" methods have become much more versatile over the past decade.
- Greater usage of "hybrid" segmentation methods. For example, a beer producer might first segment consumers according to favorite brand. Then, within each brand group, consumers could be further segmented according to similarities in attitudes towards beer drinking, occasions where beer is consumed, and so on.

EXHIBIT 5-7
How Tech Customers Stack Up

| | CAREER | FAMILY | ENTERTAINMENT |
|------------|--|---|--|
| OPTIMISTS | FAST FORWARDS These consumers are the biggest spenders, and they're early adopters of new technology for home, office, and personal use. | NEW AGE NURTURERS Also big spenders, but focused on technology for home uses, such as a family PC. | MOUSE POTATOES They like the online world for entertainment and are willing to spend for the latest in technology. |
| | TECHNO-STRIVERS Use technology from cell phones and pagers to online services primarily to gain a career edge. | DIGITAL HOPEFULS Families with a limited budget but still interested in new technology. Good candidates for the under-\$1,000 PC. | GADGET-GRABBERS They also favor online entertainment but have less cash to spend on it. |
| PESSIMISTS | HAND-SHAKERS Older consumers—typically managers—who don't touch their computers at work. They leave that to younger assistants. | TRADITIONALISTS Willing to use technology but slow to upgrade. Not convinced upgrades and other add-ons are worth paying for. | MEDIA JUNKIES Seek entertainment and can't find much of it online. Prefer TV and other older media. |
| | SIDELINED CITIZENS Not interested in technology. | | |
| |  MORE AFFLUENT |  LESS AFFLUENT | |

Source: Forrester Research, Inc.

- A closer connection between segmentation methods and new product development. Computer choice models (using information about the attribute trade-offs that consumers make) can now find the best segments for a given product profile or the best product profile for a given market segment.
- The growing availability of computer models (based on conjoint data) to find optimal additions to product lines—products that best balance the possibility of cannibalization of current products with competitive draw.
- Research on dynamic product/segment models that consider the possibility of competitive retaliation. Such models examine a company's vulnerability to competitive reactions over the short term and choose product/segment combinations that are most resistant to competitive encroachment.
- The development of pattern-recognition and consumer-clustering methods that seek segments on the basis of data but also respect managerial constraints on minimal segment size and managerial weightings of selected clustering variables.
- The development of flexible segmentations that permit the manager to loosen a clustering based only on buyer needs (by shifting a small number of people

between clusters); the aim might be to increase the predictability of some external criterion, such as household profitability to a company, say, selling mutual funds.

*Micromarketing, or
Segment-of-One
Marketing*

An interesting development in the past few years has been the emergence of a new segmentation concept called micromarketing, or segment-of-one marketing. Forced by competitive pressures, mass marketers have discovered that a segment can be trimmed down to smaller subsegments, even to an individual. Micromarketing combines two independent concepts: information retrieval and service delivery. On one side is a proprietary database of customers' preferences and purchase behaviors; on the other is a disciplined, tightly engineered approach to service delivery that uses the database to tailor a service package for individual customers or a group of customers. Of course, such custom-designed service is nothing new, but until recently, only the very wealthy could afford it. Information technology has brought the level of service associated with the old carriage trade within reach of the middle class.¹⁷

Micromarketing requires:

1. **Knowing the customers**—Using high-tech techniques, find out who the customers are and aren't. By linking that knowledge with data about ads and coupons, fine-tune marketing strategy.
2. **Making what customers want**—Tailor products to individual tastes. Where once there were just Oreos, now there are Fudge Covered Oreos, Oreo Double Stufs, and Oreo Big Stufs.
3. **Using targeted and new media**—Advertising on cable television and in magazines can be used to reach special audiences. In addition, develop new ways to reach customers. For example, messages on walls in high-school lunchrooms, on videocassettes, and even on blood pressure monitors may be considered.
4. **Using nonmedia**—Sponsor sports, festivals, and other events to reach local or ethnic markets.
5. **Reaching customers in the store**—Consumers make most buying decisions while they are shopping, so put ads on supermarket loudspeakers, shopping carts, and in-store monitors.
6. **Sharpening promotions**—Couponing and price promotions are expensive and often harmful to a brand's image. Thanks to better data, some companies are using fewer, more effective promotions. One promising approach: aiming coupons at a competitor's customers.
7. **Working with retailers**—Consumer-goods manufacturers must learn to "micro market" to the retail trade, too. Some are linking their computers to retailers' computers, and some are tailoring their marketing and promotions to an individual retailer's needs.

An example of micromarketing is provided by a North Carolina bank, First Wachovia.¹⁸ The bank's staff serves all customers the way it used to serve its best customer. The staff greets each customer by name and provides personalized information about her or his finances and how they relate to long-term objectives. Based on this knowledge, the staff suggests new products. In this way, the commodity retail banking has been turned into a customized, personalized service. This marketing strategy has resulted in more sales at lower marketing costs and

powerful switching barriers relative to the competition. Three major investments are behind this seemingly effortless new level of service: a comprehensive customer database, accessible wherever the customer makes contact with the bank; an extensive training program that teaches a personalized service approach; and an ongoing personal communications program with each customer. Similarly, Noxell's Clarion line illustrates how micromarketing can be implemented. When the company introduced its line of mass market cosmetics in drugstores, it looked for a way to differentiate it in a crowded market. The answer was the Clarion computer. Customers type in the characteristics of their skin and receive a regimen selected from the Clarion line, thus providing department store-type personal advice without sales pressure in the much more convenient drug channel.

SUMMARY

This chapter examined the role of the third strategic C—the customer—in formulating marketing strategy. One strategic consideration in determining marketing strategy is the definition of the market. A conceptual framework for defining the market was outlined.

The underlying factor in the formation of a market is customer need. The concept of need was discussed with reference to Maslow's hierarchy of needs. Once a market emerges, its worth must be determined through examining its potential. Different methods may be employed to study market potential.

Based on its potential, if a market appears worth tapping, its boundaries must be identified. Traditionally, market boundaries have been defined on the basis of product/market scope. Recent work on the subject recommends that market boundaries be established around the following dimensions: technology, customer function, and customer group. Level of production/distribution was suggested as a fourth dimension. The task of market boundary definition amounts to grouping together a set of market cells, each defined in terms of these dimensions.

Market boundaries set the limits of the market. Should a business unit serve a total market or just a part of it? Although it is conceivable to serve an entire market, usually the served market is considerably narrower in scope and smaller in size than the total market. Factors that influence the choice of served market were examined.

The served market may be too broad to be served by a single marketing program. If so, then the served market must be segmented. The rationale for segmentation was given, and a procedure for segmenting the market was outlined.

DISCUSSION QUESTIONS

1. Elaborate on marketing's boundary role function. How is it related to customer needs?
2. What dimensions may be used to define market boundaries?
3. Illustrate the use of these dimensions with a practical example.
4. What is meant by served market? What factors determine the served market?
5. How may a business unit choose the criteria for segmenting the market?

6. Describe the concept of micromarketing. How may a durable goods company adopt it to its business?

NOTES

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- ⁹ Day and Shocker, *Identifying Competitive Product-Market Boundaries*.
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- ¹³ Luis D. Arjona, Rajesh Shah, Alejandro Tinivelli and Adam Weiss, "Marketing to the Hispanic Consumer," *The McKinsey Quarterly*, No. 3, (1998): 106–115.
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- ¹⁷ Edward Feitzinger and Hau L. Lee, "Mass Customization at Hewlett-Packard: The Power of Postponement," *Harvard Business Review*, (January–February 1997): 116–123.
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