Chapter 3

THE CUSTOMER AND MARKET AUDIT PART 1: UNDERSTANDING MARKETS AND MARKET SEGMENTATION*

SUMMARY

PART 1

- A discussion of whom we sell to
- The difference between consumers and customers
- Why market share is important and why the term 'market' must be carefully defined
- Pareto analysis (the 80/20 rule) and its implications
- The market segmentation process is outlined. The steps are:
  - defining the market
  - market mapping
  - listing decision makers and their purchases
  - noting why these decision makers buy what they buy
  - combining like-minded decision makers into segments by means of cluster analysis
- A quick market segmentation method is provided

(*Continued*)

*This chapter contains some extracts from *Market Segmentation: How to Do It and How to Profit from It* by Malcolm McDonald and Ian Dunbar (Wiley, 2012).[1] These are reproduced with the permission of the authors.

Marketing Plans: How to Prepare Them, How to Profit From Them, Eighth Edition
By Malcolm McDonald and Hugh Wilson

- Examples of market segmentation are provided
- Exercises to turn the theory into actionable propositions

Part 2 (i.e. Chapter 4) focuses on the needs of segments and how to develop value propositions

Part 3 (i.e. Chapter 5) focuses on what we sell to our customers

INTRODUCTION

Now that we understand the process of marketing planning, we can begin to look in more detail at its principal components. We have, as it were, seen the picture on the front of the jigsaw puzzle; we can now examine the individual pieces with a better understanding of where they fit.

The next three chapters are designed to help us to carry out a meaningful marketing audit. We have already looked at the issues that need to be considered; what we need now are the means to help us to undertake such an analysis.

It should be stressed that, while the following two chapters deal specifically with how to carry out a customer, market and product audit, it should not be assumed that, in carrying out a marketing audit, price, promotion, place, information and organization are unimportant. Indeed, Chapters 7–11 are devoted to these important determinants of commercial success and will provide the marketing auditor with the necessary confidence to carry out these specific parts of the audit.

It is also important to stress that we are still dealing with steps 3 to 9 in the marketing planning process, which result in the all-important output of the process, the strategic marketing plan itself.

Let us remind ourselves about the all-important *output* of the strategic marketing planning process – the strategic marketing plan itself, the contents of which are shown in Figure 3.1.

The contents of a strategic marketing plan (T+3)
(less than 20 pages)

- The purpose statement
- Financial summary
- Market overview
  - how the market works
  - key segments and their needs
- SWOT analyses
- Portfolio summary
  - of SWOTs
- Assumptions
- Objectives and strategies
- Budget for three years

Figure 3.1: The contents of a strategic marketing plan.

The Customer and Market Audit is in three parts:

PART 1 Understanding Markets and Market Segmentation (Chapter 3)
PART 2 Understanding Needs and Developing Value Propositions (Chapter 4)
PART 3 The Product Audit. What we offer our customers (Chapter 5)

It will be recalled that the contents of the strategic marketing plan, outlined in Chapter 2, represent the summarized conclusions emanating from the marketing audit and will only be as good as the audit allows. The marketing audit itself should be a separate step in the process and under no circumstances should voluminous data and analyses appear in the plan itself. All of this rightly belongs in the marketing audit document.

Thus, the marketing audit is a crucial stage in the marketing plan itself, the actual contents of which are set out in more detail in Chapter 14.

At this point, let us revisit our earlier definition of marketing and the accompanying diagram, shown here as Figure 3.2.

Marketing is a process for:

- defining markets
- quantifying the needs of the customer groups (segments) within these markets
- determining the value propositions to meet these needs
- communicating these value propositions to all those people in the organization responsible for delivering them and getting their buy-in to their role
- playing an appropriate part in delivering these value propositions (usually only communications)
- monitoring the value actually delivered.

For this process to be effective, organizations need to be consumer/customer driven.

This process is clearly cyclical, in that monitoring the value delivered will update the organization's understanding of the value that is required by its customers. The cycle may be predominantly an annual one, with a marketing plan documenting the output from the 'understand value' and 'create value proposition' processes, but equally changes throughout the year may involve fast iterations around the cycle to respond to particular opportunities or problems.

This chapter and Chapters 4 and 5 describe the process involved in this first box under the headings 'The customer and market audit' and 'The product audit', both being integral to defining markets and understanding and quantifying the value required by the customer groups (segments) within these markets.

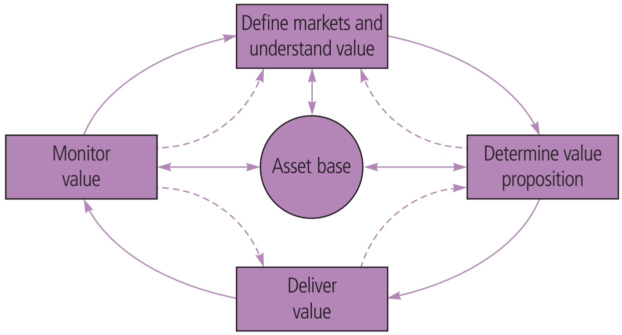


Figure 3.2: Overview of marketing map.

Input to this process will commonly include:

- The corporate mission and objectives, which will determine which markets are of interest.
- External data such as market research.
- Internal data which flows from the *deliver value* activities.

The process in the first box in Figure 3.2 involves four major subprocesses, shown in Figure 3.3. First, it is necessary to define the markets the organization is in, or wishes to be in, and how these divide into segments of customers with similar needs. The choice of markets will be influenced by the corporate objectives as well as the asset base. Information will be collected about the markets, such as the markets' size and growth, with estimates for the future.

Once each market or segment has been defined, it is necessary to understand what value the customers within the segment want or need. This value is most simply thought of as the benefits gained from the product or service, but it can also encompass the value to the customer of surrounding services such as maintenance or information. This step also encompasses what the customer is prepared to give in exchange, in terms of price and other sacrifices, such as lifetime running cost or convenience of purchase. One way of expressing customer value requirements is via a critical success factor analysis which might list such criteria as product specification, quality or reliability, the quality and range of services, price and the ease of purchase, and which might also include weights to illustrate their relative importance to the customer in the buying decision.

This step of 'Understand value required' also includes predicting the value which will be required in the future.

In performing this step, it may emerge that subsets of the customers within a market have very different requirements. In this case, the market may need to be further segmented to represent these subsets. Hence there is an important feedback loop from this step to the 'Define markets' step. How markets are defined and segmented will be spelled out later in this chapter.

'Understand competitor value positioning' refers to the process of establishing how well the organization and its competitors currently deliver the value that the customers seek. To illustrate in terms of critical success factors, this process would correspond to scoring the organization and its

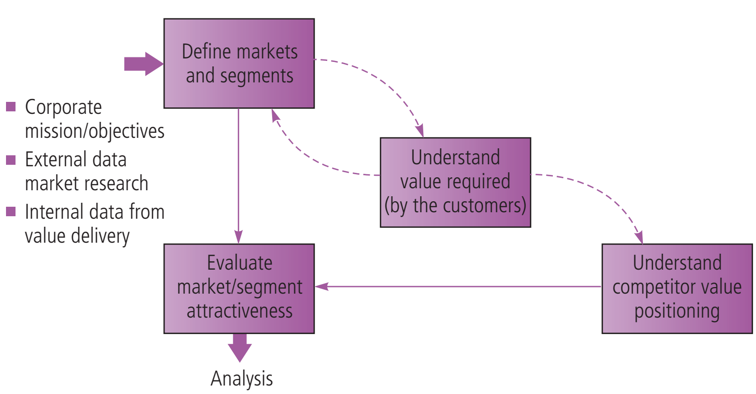


Figure 3.3: Define markets and understand value.

competitors on each of the customers' critical success factors. Again it involves looking into the future to predict how competitors might improve, clearly a factor in planning how the organization is to respond. SWOT analysis is one tool used here and will be explained in detail in Chapter 5.

From these three processes, the relative attractiveness of the different markets or segments can be evaluated.

The output will be some form of analysis, such as a 'marketing audit'. One way of summing up much of the key information is a portfolio matrix such as a Boston Matrix or a Directional Policy Matrix. These are explained in detail in Chapter 5.

The consumer is the final consumer of goods or services. Customers are people or organizations who buy directly from us.

We now turn our attention to one of the key determinants of successful marketing planning – *market segmentation*. This is fundamental to the matching process described in Chapter 1. But, in order to understand market segmentation, it is first necessary to appreciate the difference between ▶ customers and ▶ consumers, the meaning of *market share* and the phenomenon known as the *Pareto effect*.

THE DIFFERENCE BETWEEN CUSTOMERS AND CONSUMERS

Let us start with the difference between customers and consumers. The term 'consumer' is interpreted by most to mean the final consumer, who is not necessarily the customer. Take the example of a mother or father who is buying breakfast cereals. The chances are that they are intermediate customers, acting as agents on behalf of the eventual consumers (their family) and, in order to market cereals effectively, it is clearly necessary to understand what the end-consumer wants, as well as what the parents want.

The term 'customers' in the definition refers to the final users of the product or service being bought.

This is only relevant in that it is always necessary to be aware of the needs of eventual consumers down the buying chain.

Consider the case of the industrial purchasing officer buying raw materials such as wool tops for conversion into semi-finished cloths, which are then sold to other companies for incorporation into the final product, say a suit, or a dress, for sale in consumer markets. Here, we can see that the requirements of those various intermediaries and the end user are eventually translated into the specifications of the purchasing officer to the raw materials manufacturer. Consequently, the market needs that this manufacturing company is attempting to satisfy must in the last analysis be defined in terms of the requirements of the ultimate users – the consumer – even though the direct customer is quite clearly the purchasing officer.

Given that we can appreciate the distinction between customers and consumers and the need constantly to be alert to any changes in the ultimate consumption patterns of the products to which our own contributes, the next question to be faced is: who are our customers?

Direct customers are those people or organizations who actually buy direct from us. They could, therefore, be distributors, retailers and the like. However, as intimated in the previous paragraph, there is a tendency for organizations to confine their interest, hence their marketing, only to those who actually place orders. This can be a major mistake, as can be seen from the following case history.

A fertilizer company that had grown and prospered during the 1970s and 1980s because of the superior nature of its products, reached its farmer consumers via merchants (wholesalers). However, as other companies copied the technology, the merchants began to stock competitive products and drove prices and margins down. Had the fertilizer company paid more attention to the needs of its different farmer groups and developed products especially for them, based on farmer segmentation, it would have continued to create demand pull through differentiation.

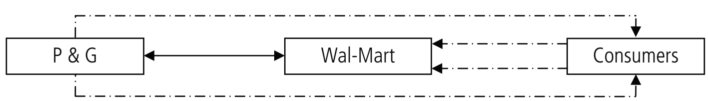
This company recovered its position by understanding the needs of its different farmer groups and targeting them with specific propositions, resulting in it becoming the most profitable company in its sector.

A fuller explanation of how it did this is provided later in this chapter.

MARKETING INSIGHT

There are countless other examples of companies which, because they did not pay sufficient attention to the needs of users further down the value chain, gradually ceased to provide any real value to their direct customers and eventually went out of business.

An excellent example of good practice is Procter & Gamble (P&G) in the USA supplying Wal-Mart, the giant food retailer. As can be seen from the simple diagram below, P&G create demand pull (hence high turnover and high margins) by paying detailed attention to the needs of consumers. But they also pay detailed attention to the needs of their direct customer, Wal-Mart. Wal-Mart are able to operate on very low margins because, as the bar code goes across the till, this is when P&G invoice them, produce another and activate the distribution chain, all of this being done by means of integrated IT processes. This way, they have reduced Wal-Mart's costs by hundreds of millions of dollars.



Closely related to the question of the difference between customers and consumers is the question of what our market share is.

MARKET SHARE

Most business people already understand that there is a direct relationship between relatively high share of any market and high returns on investment, as shown in Figure 3.4.

Clearly, however, since BMW are not in the same market as Ford, for example, it is important to be most careful about how 'market' is defined. Correct market definition is crucial for: measuring market share and market growth; the specification of target customers; recognition of relevant competitors; and, most importantly of all, the formulation of marketing strategy, for it is this, above all else, that delivers differential advantage.

The general rule for 'market' definition is that it should be described in terms of a customer need in a way which covers the aggregation of all the products or services which customers regard as being capable of satisfying the same need. For example, we would regard the in-company caterer as only one option when it came to satisfying lunchtime hunger. This particular need

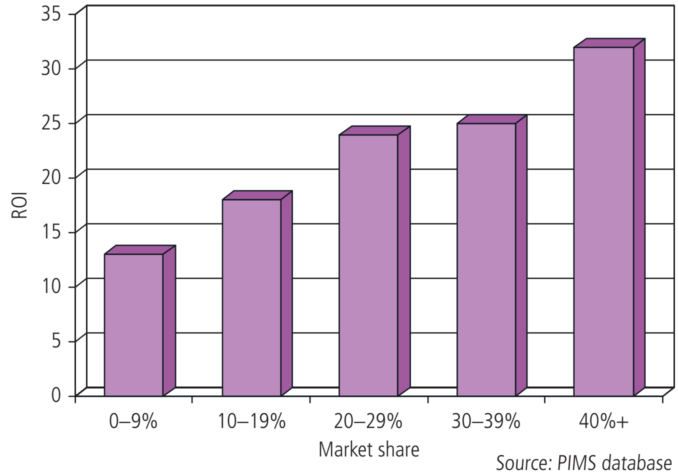


Figure 3.4: The relationship between market share and return on investment.

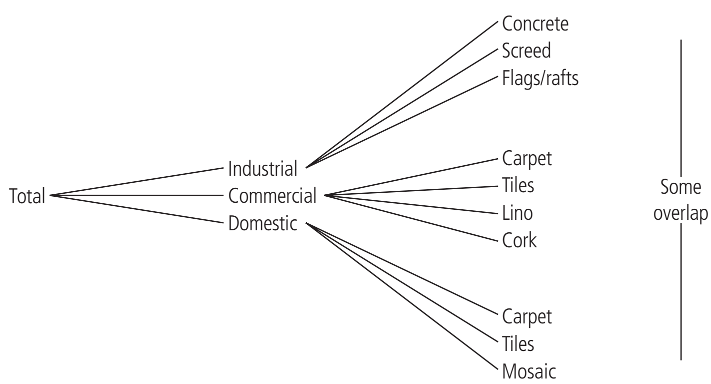
could also be satisfied at external restaurants, public houses, fast food specialists and sandwich bars. The emphasis in the definition, therefore, is clearly on the word 'need'.

A market is the aggregation of all the products or services which customers regard as being capable of satisfying the same need.

Aggregating currently available products/services is, however, simply an aid to arriving at the definition, as it is important to recognize that new products, yet to be developed, could better satisfy the users' needs. For example, the button manufacturer who believed their market was the 'button market' would have been very disappointed when zips and Velcro began to satisfy the need for fastenings! A needs-based definition for this company would have enabled the management to recognize the fickleness of current products, and to accept that one of their principal tasks was to seek out better ways of satisfying their market's needs and to evolve their product offer accordingly.

The following example may help in defining the market your business is in.

A company manufacturing nylon carpet for the commercial sector wanted to check that it had a realistic definition of the market it was in. The first step was to map out the total available market for all floor covering:



Clearly, it would be wrong to include the three types of floor covering used in the industrial sector in the company's market definition. The qualities required from such flooring cannot hope to be matched in a carpet made from any currently known type of fibre. Similarly, in both the commercial and domestic sectors, nylon carpet is not a competitor for the luxury end of the market. This luxury part of the market buys carpet made from natural fibres, particularly wool.

This leaves the non-luxury commercial and domestic sectors which, in total, represented the company's potential available market. It was potentially available because the company could, for example, produce nylon carpet for the domestic sector and extend its market this way. Similarly, the company could move into manufacturing nylon carpet tiles and extend its operation into this product for both the domestic and commercial sectors. There was also no reason why the company should not look at replacing lino, cork or mosaic flooring with nylon carpet.

Many of the opportunities in the potentially available market, however, represent possible strategies for the future. They would be considered during the marketing planning process when the future plans for the current business activity did not achieve the required financial targets. The question now, therefore, is, what is the company's realistically available market?

To assist the company in this final stage of arriving at a market definition the 'needs' being met by the current products, as highlighted by the current customers, were first listed. This revealed that the company's nylon carpet was bought because:

- it fell into a particular price range
- it was quiet underfoot
- it had a life expectancy of 15 years
- it was available in pleasant colours and textures
- the market was within a 60-mile radius of the manufacturing plant.

In addition to the obvious, this list removed lino, cork and mosaic from the company's available market.

Finally, the company looked at the applicability of its current distribution and selling methods to the potentially available market, ruling out those sections of the market which required different selling and distribution approaches. This meant that it was unrealistic to include the domestic sector in the market definition.

> It is necessary to arrive at a meaningful balance between a wide market definition and a manageable market definition.

Products and manufacturers which met all the criteria were then listed, along with their end users. The company had now arrived at both a market definition and a current market size, while still keeping open the option of extending it, should the need arise.

This example also illustrates the need to arrive at a meaningful balance between a wide market definition and a manageable market definition. Too narrow a definition has the pitfall of restricting the range of new opportunities segmentation could open up for your business.

On the other hand, too wide a definition may make marketing planning meaningless. For example, the television broadcasting companies are in the 'entertainment' market, which also consists of theatres, cinemas and theme parks, to name but a few. This is a fairly wide definition. It may, therefore, be more manageable for the television broadcasters, when looking at segmenting their market, to define their market as being the 'home entertainment' market. This could then be further refined into the pre-school, child, teenager, family or adult home entertainment market.

To help with calculating market share the following definitions are useful:

- Product class, e.g. cigarettes, computers, fertilizers, carpets.
- Product subclass, e.g. filter, personal computers, nitrogen, carpet tiles.
- Product brand, e.g. Lynx, IBM, Intel, Heuga.

Lynx as a brand, for the purpose of measuring market share, is only concerned with *the aggregate of all other brands that satisfy the same group of customer wants*. Nevertheless, the manufacturer of Lynx also needs to be aware of the sales trends of deodorants and the personal care market in total.

One of the most frequent mistakes that is made by people who do not understand what market share really means is to assume that their company has only a small share of some market, whereas if the company is commercially successful, it probably has a much larger share of a smaller market.

While it is tempting to think that the examples given above amount to 'rigging' the definition of market and that there is the danger of fooling ourselves, we must never lose sight of the purpose of market segmentation, which is to enable us to create competitive advantage for ourselves by creating greater value for our customers.

MARKETING INSIGHT

Thus, for the carpet manufacturer, or for a London orchestra that defines its market as the aggregation of all London classical orchestras rather than as all entertainment, as long as its market definition enables it to outperform its competitors and grow profitably, this is the key. Obviously, however, the definition needs to be kept under review and revised, if necessary.

To summarize, correct market definition is crucial for the purpose of:

- share measurement
- growth measurement
- the specification of target customers
- the recognition of relevant competitors
- the formulation of marketing objectives and strategies.

This brings us to another useful and fascinating observation about markets.

PARETO EFFECT

It is a phenomenon commonly observed by most companies that a small proportion of their customers account for a large proportion of their business. This is often referred to as the 80/20 rule, or the ▶ Pareto effect, whereby about 20 per cent of customers account for about 80 per cent of business.

Pareto's law indicates that approximately 20 per cent of any activity will result in approximately 80 per cent of the output.

If we graph the proportion of customers that account for a certain proportion of sales, then we might expect to find a relationship similar to that shown in Figure 3.5. Here, customers have been categorized simply as A, B or C according to the proportion of sales they account for. The A customers, perhaps 25 per cent of the total, account for about 70 per cent of sales; B customers, say 55 per cent of the total, account for 20 per cent of total sales; and C customers, 20 per cent of the total, account for the remaining 10 per cent of sales.

The Pareto effect is found in almost all markets, from capital industrial goods to banking and consumer goods. What is the significance of this? What is certain is that it does not mean that a company should drop 80 per cent of its customers! For one thing, the sales volume bought by these customers makes a valuable contribution to overheads. For another, it is almost certain that the 80/20 rule would still apply to the remaining 20 per cent. One could go on forever, until there was only a single customer left! However, in carrying out this kind of analysis, it should become obvious where the company should be placing its greatest effort.

There are, however, two serious dangers. The first is that this form of analysis is static. In other words, the best potential customers may well be in the 80 per cent, or even in the larger group of non-customers. The second is that the same analysis needs to be done for profitability, preferably using activity-based costing (ABC) to establish whether the top 20 per cent of customers are also contributing to the largest proportion of profits.

It is obvious, then, that while such analysis is vital, great care is necessary over how it is used. This is something we can now begin to discuss.

One manufacturer in the soft drinks industry did an analysis of its trade in the south-east of England and found that almost 85 per cent of its trade was coming from 20 per cent of its customers. Yet exactly the same service was being given to them all. All were receiving fortnightly calls from the sales force, all received a fortnightly delivery, and all paid the same price for the

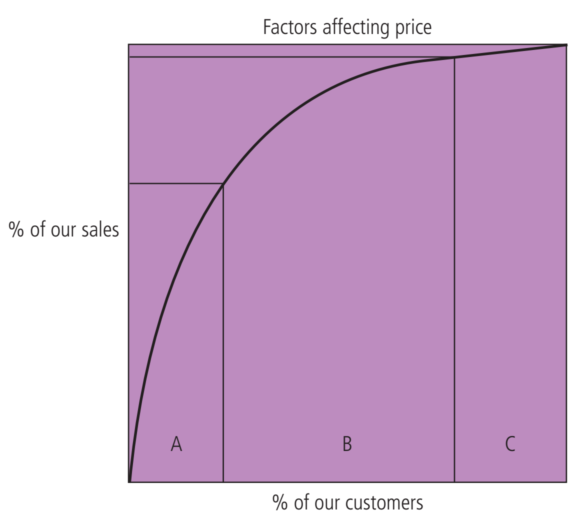


Figure 3.5: The '80/20' effect.

product. Not surprisingly, this led to an enormous investment in depots and vehicles, while the associated operating expenses were out of all proportion to the margins enjoyed by the company. In this case, there was a simple answer. Most of the small accounts were handed over to a grateful wholesaler, which freed valuable capital and management time to concentrate on the really important areas of the business. Meanwhile, the company's pricing policy was revised to reward those customers who bought more, and the sales force was now free to concentrate on developing its existing business and on opening new profitable outlets.

MARKETING INSIGHT

The chairman of one European airline, alas now bankrupt, told his assembled general managers that his ambition was for his airline to be the best in the world and to provide customer service to the point of obsession. The problem was that his airline didn't compete in many markets, while their unfocused customer obsession policy led them to give service they just couldn't afford. Heroic and unfocused statements such as this chairman's do more harm than good!

One of the most important aspects of marketing planning is being able to choose the best 20 per cent of your market to focus on, the 'best' being the most profitable now and in the future. A method of doing this will be provided in Chapter 5.

MARKET DEFINITION AND SEGMENTATION

Introduction

It has become clear after at least 70 years of formalized marketing that market definition and segmentation are the very core of the discipline.

How to measure market share has always been at the centre of controversy in discussions of success or failure. As stated earlier, defining a market too widely or too narrowly can both lead to meaningless statistics.

> A market segment consists of a group of customers within a market who share a similar level of interest in the same, or comparable, set of needs.

The remainder of this chapter deals in detail with these problems.

While this is not the place to spell out the academic history of market segmentation, it is so crucial to the success of marketing planning that at least a brief commentary is called for. One of the authors of this chapter did a catholic review of scholarly research into the earlier history of market segmentation (Jenkins and McDonald, 1997)[2] in which 36 references were cited. However, due to scale constraints here is a very brief summary of this research and more recent developments.

The father of market segmentation is widely considered to be Wendell Smith (1956),[3] who proposed market segmentation as an alternative to product differentiation. Yet it wasn't until Wind's (1978)[4] review of the state of market segmentation that the topic went to the top of the agenda of researchers and practitioners. His plea was for new segmentation bases, data analysis techniques and for generally putting market segmentation at the heart of strategic decision making.

In 2009, a whole issue of the *Journal of Marketing Management* was devoted to market segmentation and for those readers wanting an updated literature review, see one of the author's articles in that issue.[5] They confirm that most of the work over the intervening years has been primarily around what segmentation bases to use, such as size of purchase, customer characteristics, product attributes, benefits sought, service quality, buying behaviour and, more recently, propensity to switch suppliers, with much of this work being biased towards fast-moving consumer goods rather than to business-to-business and services.

In 2002, Coviello[6] and a host of others, with the advent of relationship marketing and CRM, proposed one-to-one as a successor to market segmentation, although Wilson et al. (2002)[7] found that most CRM projects fail because of poor segmentation. Rigby (2002)[8] summed this up succinctly by saying that trying to implement CRM without segmentation is like 'trying to build a house without engineering measures or an architect's plan'.

Given the amount of academic scholarships and attempts at implementation in the world of practice over the 60 years since Wendell Smith first raised the consciousness of the community to the importance of market segmentation, it is surprising that so little progress has been made. In 2006, Christensen,[9] in the *Harvard Business Review* found that of 30,000 new products launched in the USA, 85 per cent failed because of poor market segmentation. Yankelovich's paper in 2006[10] also reported the widespread failure of segmentation initiatives. This matches the authors' own research. Their analysis of 3,000 marketing plans revealed that only 300 contained proper needs-based segmentation – that is, 90 per cent didn't.

The authors, who have executive experience in blue chips from FMCG to IT, and having worked on practical segmentation with senior teams from leading global multinationals down to SMEs for 30 years, find much of the academic debate referred to above somewhat arrogant and inward-looking.

The justification for saying this is that anyone who says 'we segment markets by. . .' is totally missing the point. Any market, once correctly defined in terms of needs rather than products, consists of 100 per cent of what is bought, how it is used and why it is bought and used in these ways. The role of any supplier is to understand these behavioural patterns and to discover their rationale, rather than trying to impose some predetermined segmentation methodology onto the market.

The purpose here is to spell out proven methodologies for market definition and market segmentation developed over a 20-year period of research at Cranfield School of Management. During this period, a link between shareholder value creation and excellent marketing is shown in the left hand column of Table 3.1.

Excellent strategies	Weak strategies
Target needs-based segments	Target product categories
Make a specific offer to each segment	Make similar offers to all segments
Leverage their strengths and minimize their weaknesses	Have little understanding of their strengths and weaknesses
Anticipate the future	Plan using historical data

Table 3.1: The link between shareholder value added and excellent strategies.

Essential Background

'A market is the aggregation of all the products or services which customers regard as being capable of satisfying the same need' (Malcolm McDonald and Ian Dunbar, *Market Segmentation*, Goodfellow Publishing, Oxford, 2010).

Companies frequently confuse target markets with products – pensions or mainframe computers; for example, this, coupled with a lack of knowledge about the sources of differential advantage against each segment, signals trouble. Figure 3.6 shows the first attempt at a market map by a publisher of marketing books.

Figure 3.7 shows their second attempt when, instead of defining their market as 'books', they defined their market as the promulgation of marketing knowledge in order to reflect the customers' need. This led to a whole new corporate strategy.

Many companies pride themselves on their market segmentation even though these so-called 'segments' are in fact 'sectors', which is a common misconception. Everyone with a marketing qualification knows that a segment is a group of customers with the same or similar needs and that there are many different purchase combinations within and across sectors.

But the gravest mistake of all is *a priori* segmentation. Most books incorrectly state that there are several bases for segmentation, such as socio-economics, demographics, geo-demographics

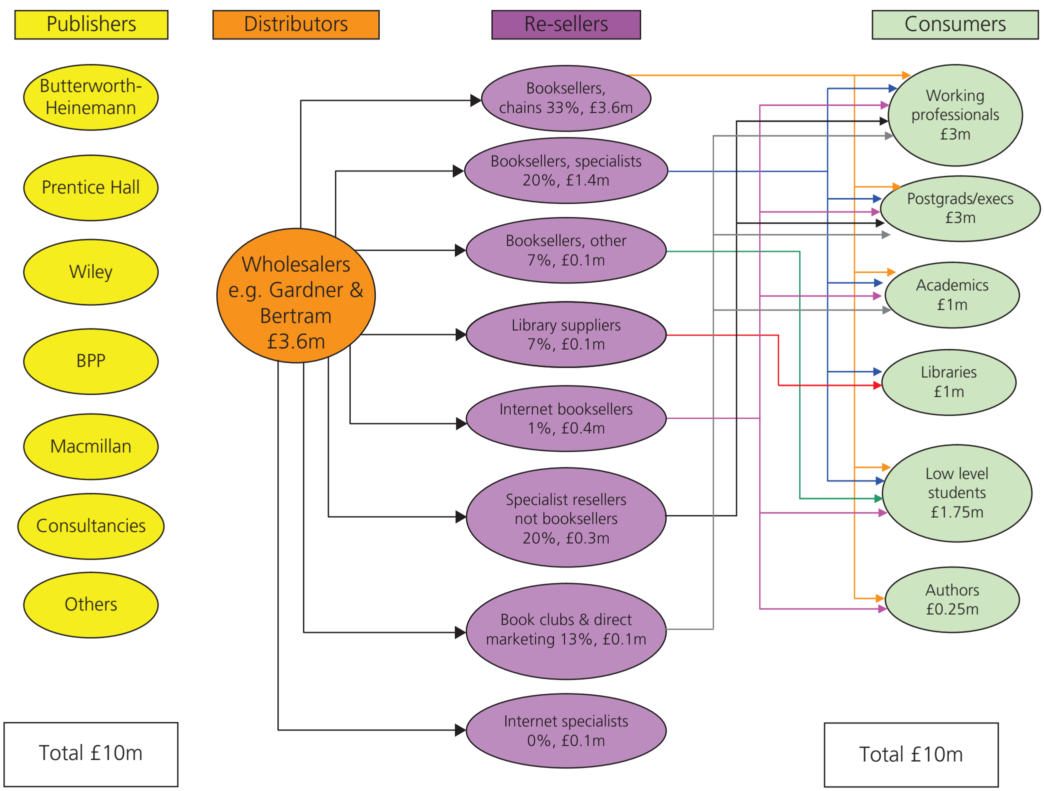


Figure 3.6: Original market map of the marketing books market.

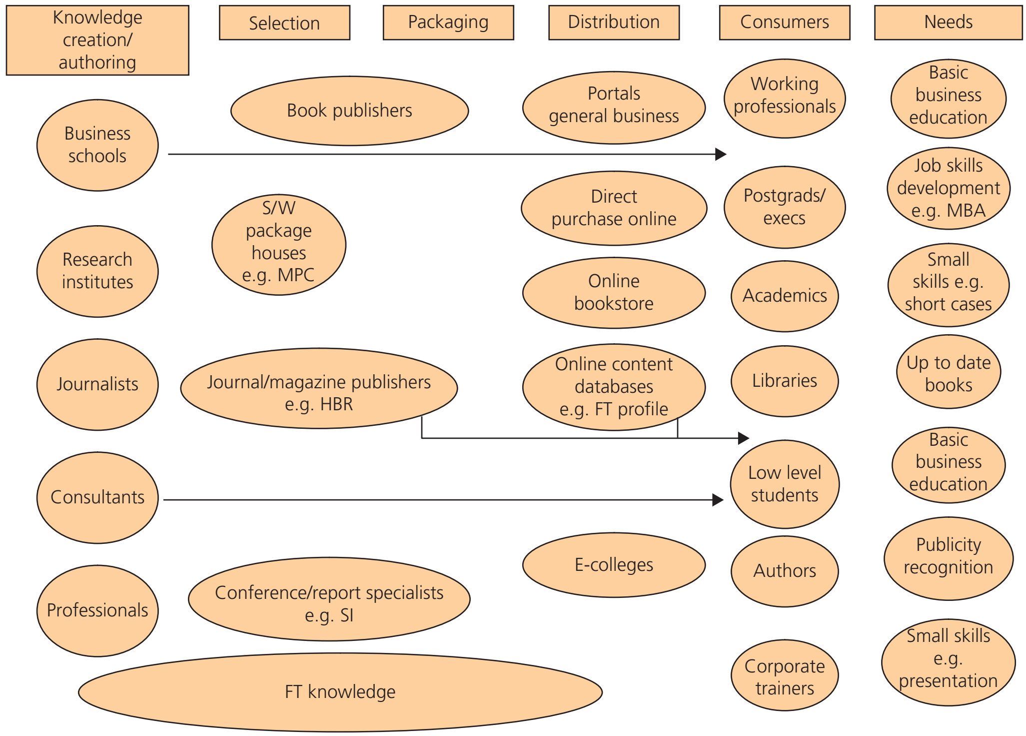


Figure 3.7: Market map of the market for the acquisition of marketing knowledge.

and the like. But this misses the point totally. For example, Boy George and the Archbishop of Canterbury are both socio-economic group A, but they don't behave the same! Nor do all 18-to 24-year-old women (demographics) behave the same! Nor does everyone in one street (geo-demographics) behave the same!

All goods and services are made, distributed and used and the purchase combinations that result make up an actual market, so the task is to understand market structure, how the market works and what these different purchase combinations (segments) are.

First, let us examine the factors that cause markets to break into smaller groups (see Figure 3.8).

When new things are invented, such as television, Skype, social media and the like, not everyone adopts them at the same time. Many years ago an American researcher, called Everett Rogers, studied how new products are defused across markets over time. Imagine that television has just been invented. Let us take any market, Germany will do, and let us imagine that there are only 100 households in Germany. Let us further imagine that there is a law limiting each household in Germany to only one television. Clearly, the potential market for televisions in Germany is 100, but not everyone buys one at the same time. Someone has to be the first to adopt new products.

Normally, about 2.5 per cent of any population will be the first to adopt new products. These people are known as 'Innovators'. They are very unusual people who enjoy being different.

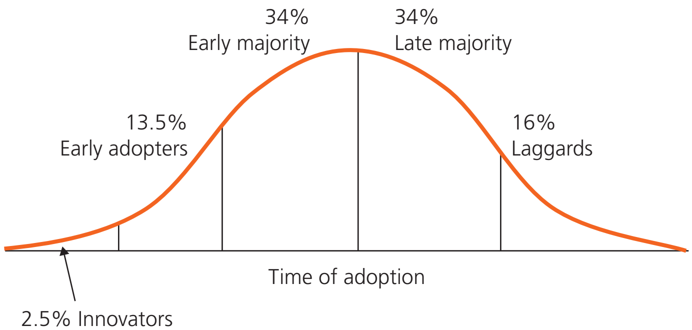


Figure 3.8: Non-cumulative diffusion pattern.
Source: Adapted from Everett Rogers

These people are followed by another group, known as 'Opinion Leaders'. They tend to be affluent, well educated and very privileged, and they are independent thinkers, who do not care much what other people think of them. They are, however, crucial in getting any new product or service adopted. We can think of them as the Joneses, in the sense of the expression: 'Keeping up with the Joneses'.

This group is followed by a much larger group known as the 'Early Majority'. These people admire the opinion leaders and can be thought of as the Smiths, in the sense of the expression: 'The Smiths try to keep up with the Joneses'. When these people start to enter a market, there is a rapid growth in sales.

By now, approximately 50 per cent of all those who could adopt the new product have done so, and it is now that the 'Late Majority' begin to enter the market. Generally, these people are less privileged and less affluent, and price often becomes important at this stage in the market.

Finally, the remaining 16 per cent of the population adopt the new technology. Everett Rogers referred to these people as 'Laggards'. By now, everyone who could have one has got one. For example, in the United Kingdom, almost everyone has a mobile phone, they are very cheap, and the market can now be considered to be a replacement market, in which growth will be dependent on population size, demographics and the like. Clearly, in mature markets, getting growth will be much more difficult.

Although this is not the purpose of this chapter, it is useful to note, before we leave the diffusion of innovation curve, that when launching a new product or service, it is advantageous to know who the opinion leaders are in a market, as these people should be targeted first by the sales force, and by other promotional media, as they will be the most likely to respond. For example, certain doctors will be more open-minded about new drugs, whereas other doctors will not risk prescribing a new drug until it has been on the market for a number of years.

The diffusion of innovation curve also explains the phenomenon known as the product lifecycle, and why, after the 50 per cent point on the diffusion of innovation curve is reached, the market continues to grow but the rate of growth begins to decline until maturity is reached (see Figure 3.9).

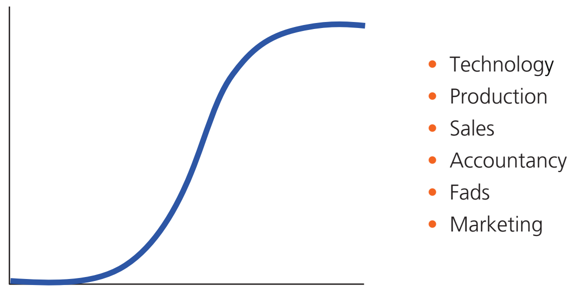


Figure 3.9: The diffusion of innovation curve.

At the beginning of any market, *technology* tends to be the driving business force, largely because new products tend to be at the cutting edge. As the new technology begins to take hold, as explained in the earlier references to the research of Everett Rogers,[12] *production* tends to be very important, because at this stage it is not unusual for demand to be greater than supply. However, as the market grows and new entrants begin to introduce competitive products, *sales* as a function becomes increasingly important, as the new competition entails a growing consumer choice. A problem frequently occurs at the next stage of the market lifecycle, as there is now more supply than demand, so frequently organizations attempt to cut costs, hence *accountancy* tends to come to the fore. This is often followed by implementing the latest management consultancy *fads*, including those promulgated by gurus such as Tom Peters in works like *In Search of Excellence*. Finally, however, all organizations come to the same conclusion, which is that they need to understand their consumers and customers better in order to meet their needs and this, of course, is where market segmentation, the subject of this section of this chapter, becomes crucial.

All this has been explained in order to introduce the key concept of market segmentation and why it happens. Clearly, in the early days, markets will tend to be homogeneous. But, as demand grows rapidly with the entry of the early majority, it is common for new entrants to offer variations on the early models, as we have just explained, and consumers now have a choice. In order to explain this more clearly, let us illustrate the approximate shape of markets. If we were to plot the car market in terms of speed and price, we would see very small, inexpensive cars in the bottom left hand corner of Figure 3.10. In the top right, we would see very fast, expensive cars. Most cars, however, would cluster in the middle; what we might call: 'The Mr and Mrs Average market'.

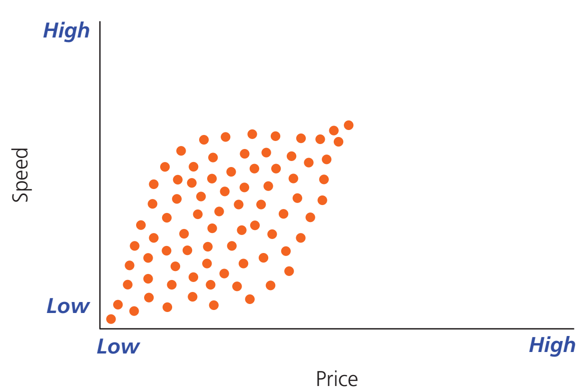


Figure 3.10: Illustration of the shape of the car market.

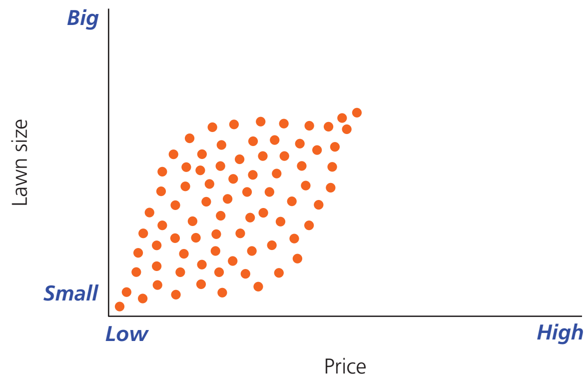


Figure 3.11: Illustration of the shape of the lawn mower market.

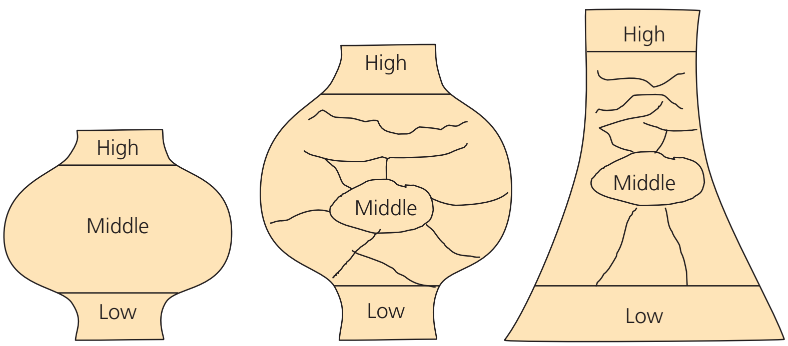


Figure 3.12: The shape of markets from birth to maturity.

In the same way, the lawn mower market would look very similar (see Figure 3.11). With lawn size on the vertical axis and price on the horizontal axis, at the bottom left would be small, inexpensive, hand-pushed mowers, with expensive sit-on machines for large estates in the right hand corner.

That leaves the majority of the market with average size lawns, and average-sized lawn mowers, which is where the mass market is.

We can redraw this to represent the shape of any market, particularly at the early growth stage (the shape on the left in Figure 3.12). But when rapid growth begins, new entrants join the market and offer variations on standard products in order to attract sales, and it is at this stage that markets begin to break into smaller groups, while still growing overall. (This is represented by the shape in the middle.) Eventually, when markets mature, and there is more supply than demand, any market growth tends to come in the lower price end of the market, while the top end of the market tends to be immune. (This is represented by the shape on the right.) It is usually the middle market that suffers at this stage, with many competitors vying with each other on price. This, however, is the whole point of market segmentation, for competing only on price is to assume that this is the main requirement of customers, whereas the truth is that this is rarely the case. It is just that a general lack of understanding about market segmentation on the part of suppliers about the real needs of customers in mature markets forces them to trade on price, so encouraging the market to become a commodity market.

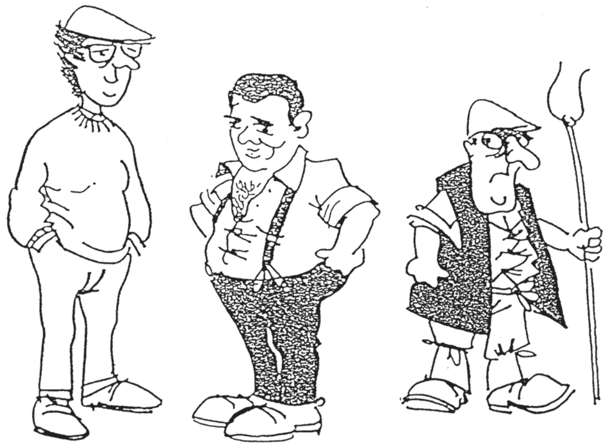


Figure 3.13: Examples of segments for the fertilizer case study.

It is not widely known that price is rarely the decisive factor in most buying situations. It is certainly the experience of the authors over many years of working on every continent of the world that price accounts for less than 10 per cent of all decisions. The following is a quote from an IPA report ('Advertising in a downturn', March 2008, p. 5). 'The average proportion of consumers who were motivated by price was around ten per cent and even if this increased during a downturn, the proportion would remain small.'

The segmentation project for the fertilizer case study referred to earlier revealed that there were seven distinct types of farmer, each with a different set of needs. Three of which are illustrated in Figure 3.13. To give just a few examples of these segments: first, there was a segment they called Arthur, a television character known for his deals. He bought on price alone but represented only 7 per cent of the market, not the 100 per cent put about by everyone in the industry, especially the sales force. Another type of farmer they called Oliver. Oliver, an arable farmer, would drive around his fields on his tractor with an aerial linked to a satellite and an on-board computer. He did this in order to analyse the soil type and would then mix P, N and K, which are the principal ingredients of fertilizer, solely to get the maximum yield out of his farm. In other words, Oliver was a scientific farmer, but the supply industry believed he was buying on price because he bought his own ingredients as cheaply as possible. He did this, however, only because none of the suppliers bothered to understand his needs. Another type of farmer they called Martin. Martin, a dairy farmer, was a show-off and liked his grass to look nice and healthy. He also liked his cows to look nice and healthy. Clearly, if a sales representative had talked in a technical way to Martin, he would quickly switch off. Equally, to talk about the appearance of crops would have switched Oliver off, but this is the whole point. Every single supplier in the industry totally ignored the real needs of these farmers, and the only thing anyone ever talked about was price. The result: a market driven by price discounts, accompanied by substantial losses to the suppliers. ICI, however, armed with this new-found information, launched new products and new promotional approaches aimed at these different farmer types, and got immediate results, becoming the most profitable subsidiary of ICI and the only profitable fertilizer company in the country.

Let us now return to market dynamics and what happens to markets at the rapid growth stage. At this stage, new entrants come into the market, attracted by the high sales and high profits enjoyed by the industry. Let us illustrate this with another case history. In the early 1970s, a photocopier company had 80 per cent market share and massive profit margins. This is represented by the big circle in the middle of Figure 3.14. When a Japanese newcomer entered the market

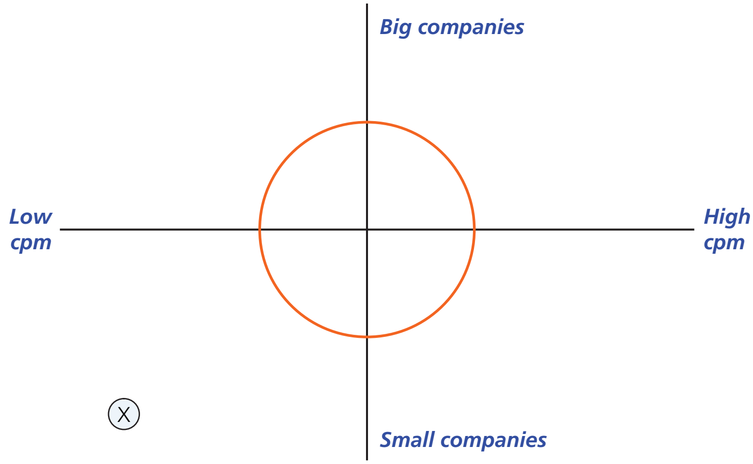


Figure 3.14: The photocopier market in the 1970s.

Key characteristics	Unique	Product differentiation	Service differentiation	"Commodity"
Marketing message	Explain	Competitive	Brand values	Corporate
Sales	Pioneering	Relative benefits distribution support	Relationship based	Availability based
Distribution	Direct selling	Exclusive distribution	Mass distribution	80 : 20
Price	Very high	High	Medium	Low (consumer controlled)
Competitive intensity	None	Few	Many	Fewer, bigger international
Costs	Very high	Medium	Medium/low	Very low
Profit	Medium/high	High	Medium/high	Medium/low
Management style	Visionary	Strategic	Operational	Cost management

Figure 3.15: The product/market lifecycle and market characteristics.

with small photocopiers, the giant ignored them. The Japanese product grew in popularity, however, forcing the giant to reduce its prices. Within three years, the giant's share was down to 10 per cent, and the battle was lost. They had failed to recognize that the market was segmented and tried to compete in all segments with their main product, a mistake made by hundreds of erstwhile market leaders. The main point about this case history is that companies should not attempt to compete in all segments with the same product, but should recognize that different segments or need groups develop as the market grows, and that they should develop appropriate products and services, and position and brand them accordingly.

Figure 3.15 summarizes all of this by showing a product lifecycle representation with some generalizations about how marketing strategies change over time (product lifecycles are explained in more detail in the next chapter). From this, which we suggest you study carefully, you will see at least four major changes that occur over the lifecycle. At the top of the far right hand column, you will see the word 'commodity', but the point we want to make is that this is by no means inevitable, and only occurs in markets where the suppliers do not understand the power of market segmentation, as illustrated in the fertilizer case history. There are other options, of course, including the option to get out of mature markets. Another is to move the goalposts as it were, somewhat in the manner of First Direct, Amazon, Airbnb, Uber, Spotify and countless others. The strategy we want to concentrate on here, however, is market segmentation, which in our view should be the very first consideration as markets begin to mature.

MARKET SEGMENTATION – HOW TO DO IT

We can now begin to concentrate on a methodology for making market segmentation a reality, market segmentation being the means by which any company seeks to gain a differential advantage over its competitors.

Markets usually fall into natural groups, or segments, which contain customers who exhibit a similar level of interest in the same, or comparable, set of needs.

These segments can be regarded as forming separate markets in themselves and can often be of considerable size. Taken to its extreme, each individual consumer is a unique market segment, for all people are different in their requirements. While CRM systems have made it possible to engage in one-to-one communications, this is not viable in most organizations unless the appropriate organizational economies of scale have been obtained at a higher level of aggregation such as at segment level. Consequently, products are made to appeal to groups of customers who share approximately the same needs.

It is not surprising, then, to hear that there are certain universally accepted criteria concerning what constitutes a viable market segment:

- Segments should be of an adequate size to provide the company with the desired return for its effort.
- Members of each segment should have a high degree of similarity in their requirements, yet be distinct from the rest of the market.
- Criteria for describing segments must enable the company to communicate effectively with them.

While many of these criteria are obvious when we consider them, in practice market segmentation is one of the most difficult of marketing concepts to turn into a reality. Yet we must succeed, otherwise we become just another company selling what are called 'me too' products. In other words, what we offer the potential customer is very much the same as what any other company offers and, in such circumstances, it is likely to be the lowest priced article that is bought. This can be ruinous to our profits, unless we happen to have lower costs, hence higher margins, than our competitors.

There are basically three stages to developing segments, all of which have to be completed (see Figure 3.16).

The first establishes the scope of the project by specifying the geographic area to be covered and defining the 'market' which is to be segmented, followed by taking a detailed look at the way this market operates and identifying where decisions are made about the competing

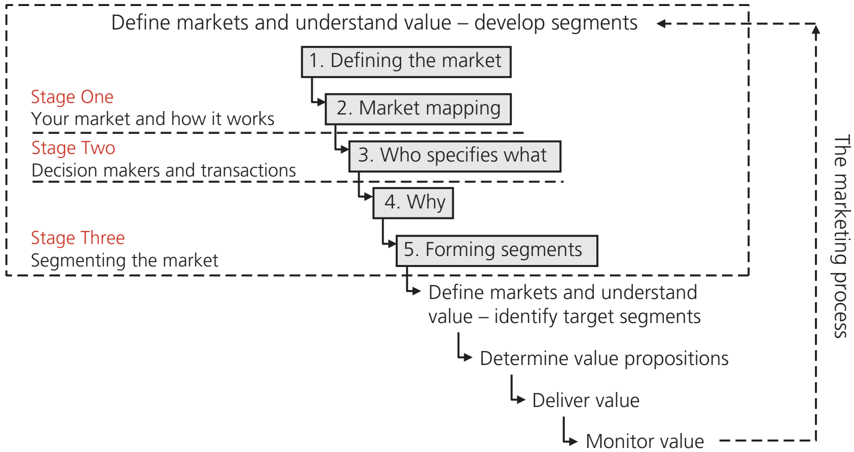


Figure 3.16: The process of developing segments and its position in the marketing process.

products or services. Successful segmentation is based on a detailed understanding of decision makers and their requirements.

The second is essentially a manifestation of the way customers actually behave in the marketplace and consists of answering the question 'Who is specifying what?'

The third stage looks at the reasons behind the behaviour of customers in the marketplace and answers the question 'Why?' and then searches for market segments based on this analysis of needs.

The following sections provide an overview of the steps required to complete these three stages and is presented in a format for conducting a segmentation project using internal resources.

Stage 1 – Your Market and How it Works

Defining the market

The first step in market segmentation establishes the scope of the segmentation project by specifying the geographic area covered by the project and by clearly understanding from a customer's perspective the 'market' in which your products or services are competing with those of your competitors. Where necessary, the scope is modified to take into account the realistic capabilities of your organization.

A clear geographic boundary enables you to size the market, to identify the localities in which the dynamics of the market have to be understood and, once the segments have been identified, to develop the appropriate marketing objectives and strategies for those localities.

Keeping the project within the borders of a single country is a manageable starting point because the stage of market development, the available routes to market and the pattern of marketing activity will probably be the same throughout the country. Even this, however, may be too broad for some companies, simply because their geographic reach is limited by physical and/or economic considerations, or even because their appeal has a strong local sentiment attached to it.

Market	Need
Car insurance	Financial protection to cover the unexpected costs of accidents and losses associated with a motor vehicle
Retirement income	The ability to maintain a desired standard of living (for self and/or dependants) from the date of retirement
Future event planning	Schemes to protect and grow money for anticipated cash calling events (e.g. car replacement/repairs, education, weddings, etc.)
Day-to-day transactions	The ability to store, access and move money as and when required
Income protection	The ability to maintain a desired standard of living (for self and/or dependants) in times of an unplanned loss of salary.

Table 3.2: Some market definitions (personal market).

For companies trading in numerous countries around the world, there is clearly an enormous attraction in finding a single global segmentation model that can be applied to every country. However, the experience of 'globalization' has highlighted for many of these companies that they have to 'act local' in order to succeed in their market. This doesn't mean that every country is completely unique in respect of the segments found within it. For the international company, a useful guide to predetermining which countries can be included in a single segmentation project is to ensure that in each of these countries the stage of market development, the available routes to market and the pattern of marketing activity are the same, or at least very similar.

As a reminder, the general rule for 'market' definition is that it should be described in a way which covers the aggregation of all the alternative products or services which customers regard as being capable of satisfying that same need.

Table 3.2 is an example from financial services.

Having established changes/developments in products and channels by defining markets in terms of needs, it is still necessary to draw a market map for your major products and services. A method for doing this is now explained.

Market mapping

A useful way of identifying where decisions are made about competing products and services and, therefore, for those who then proceed to the next stages of segmentation, is to start by drawing a 'market map'.

A ▸ market map defines the distribution and value added chain between final users and suppliers of the products or services included within the scope of your segmentation project. This should take into account the various buying mechanisms found in your market, including the part played by 'influencers'.

An example of a market map is given in Figure 3.17.

It is useful to start your market map by plotting the various stages (referred to as 'junctions') that occur along the distribution and value added chain between the final users and all the suppliers of products or services competing with each other in the defined market. At the same time,

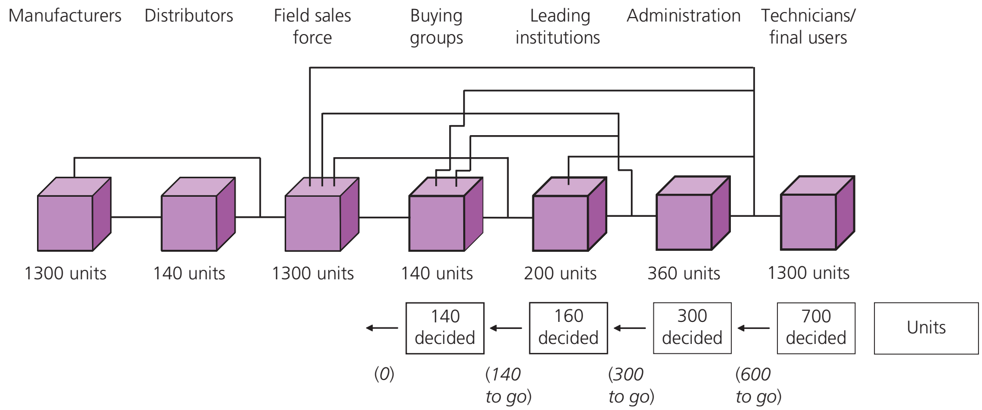


Figure 3.17: Market map – specialized technical equipment – including where decisions are made.

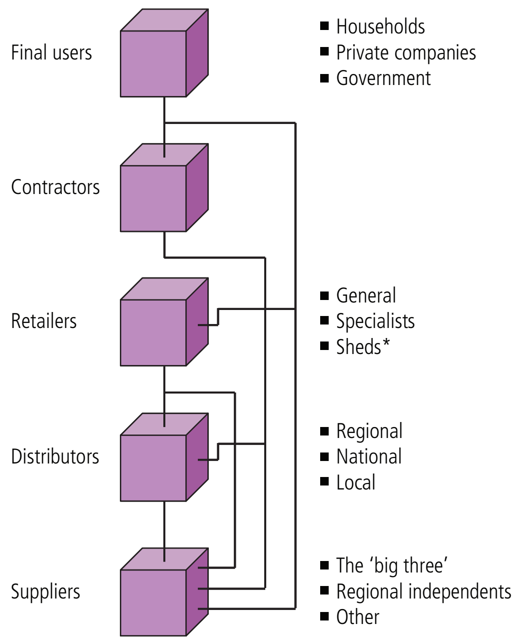


Figure 3.18: Market map listing the different junction types.

*Note:** 'Sheds' is the name sometimes used to refer to hardware superstores

indicate the particular routes to market the products are sourced through, as not all of them will necessarily involve all of these stages.

Note at each junction on your market map, if applicable, all the different types of companies/customers that are found there, as illustrated in Figure 3.18.

It is useful at this point to split the volume or value quantity dealt with by each junction between the junction types. Make the most informed estimates you can for these figures if they are not known and note this as a requirement for any follow-up work. This is shown in Figure 3.19.

Figure 3.19: Quantities split between junction types.

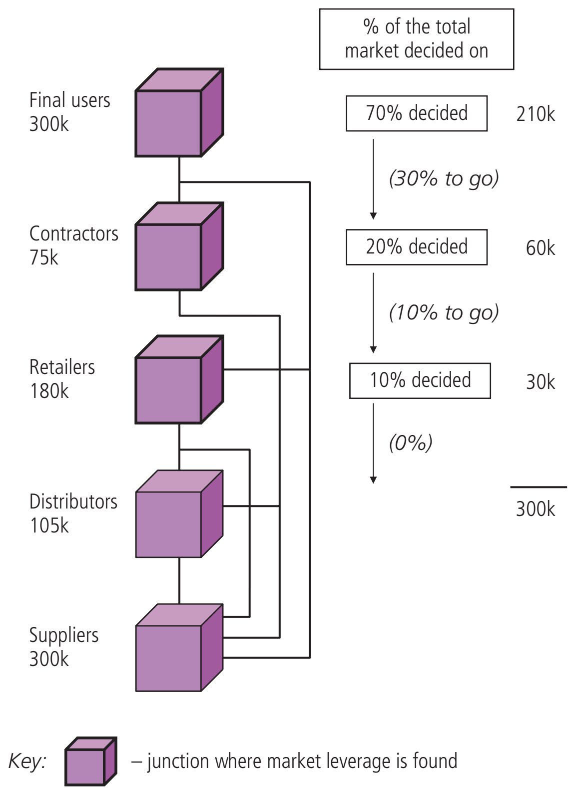


Figure 3.20: Market leverage points on a market map.

What we are particularly interested in is where decisions are made in the market (referred to as 'market leverage points') as this identifies the customer group(s) who we will take through to the next stage of the segmentation process.

The easiest junction at which to start this stage of market mapping is the final users' junction, noting at each junction with leverage the volume/value (or percentage of the total market) that is decided there. Once again make the most informed estimates you can; approximate percentages or actuals are acceptable and note this as a further requirement for any follow-up work generated by this first pass at segmenting your market. This is illustrated in Figure 3.20.

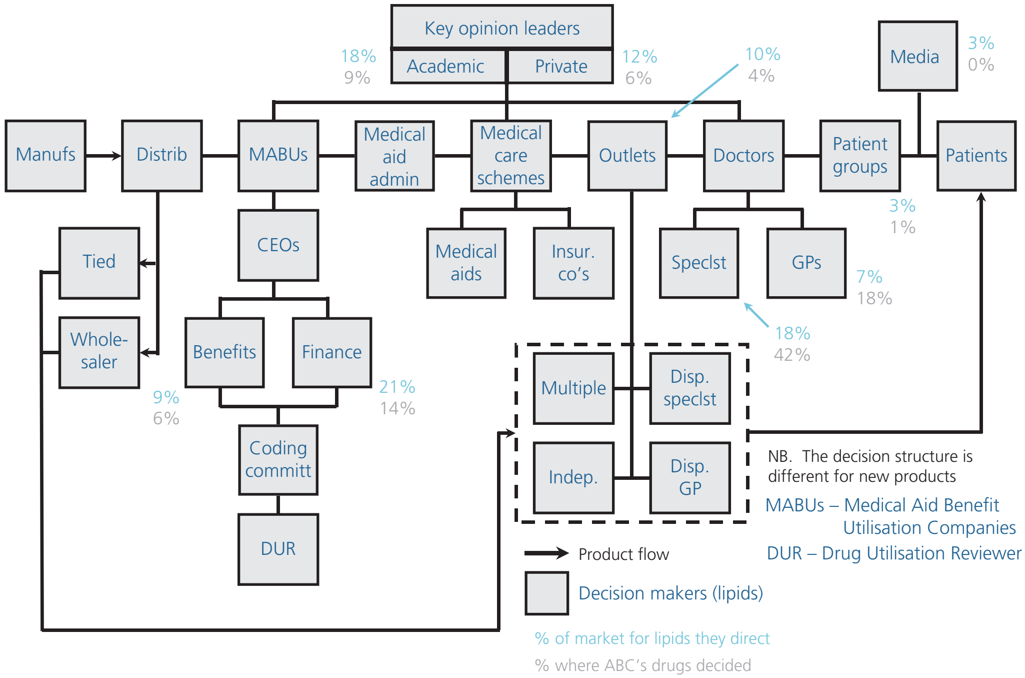


Figure 3.21: Market map – ethical drugs (South Africa).

In Figure 3.20 we see a market in which 30 per cent of annual sales are decided at junctions other than the final user junction.

An example of a pharmaceutical market map for lipids in South Africa is shown in Figure 3.21.

Without providing a detailed case history – as there isn't space here – only a brief comment is called for. The company (ABC) just wasn't putting its marketing effort into where the decisions were being made as the percentages clearly show.

A second market map (Figure 3.22) is for a type of office equipment. Once again, this map shows a disparity between where the company was putting resources and where decisions were actually being made.

The whole point of market mapping is to answer the question 'Who is the customer?' Without this knowledge of where the 80/20 rule applies in terms of where real decisions are made, market segmentation just isn't possible.

So far, we have built a market map by tracking the distribution and value added chain found between final users and suppliers, and shown the various routes that are taken through the map to link the two together. We then quantified the map. This was followed by expanding the detail to show the different types of companies/customers found at each junction on the map and these were also quantified.

We now need to take each major junction on the market map where decisions are made (i.e. 'Final users' in Figure 3.20) and apply the market segmentation process to them.

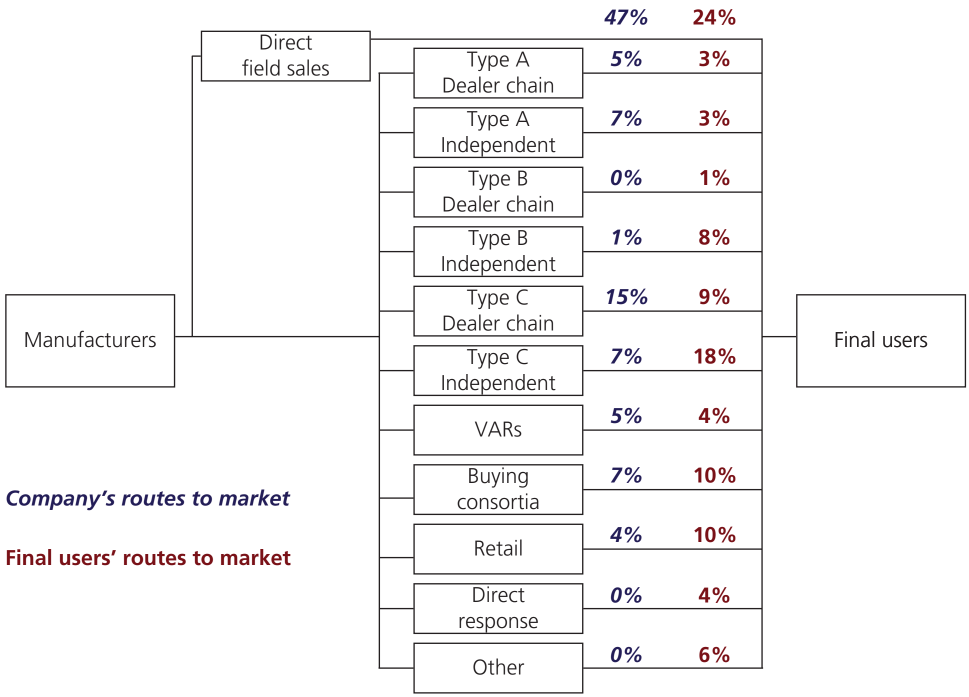


Figure 3.22: Market map – office equipment.

Stage 2 – Decision Makers and Transactions

Who specifies what, where, when and how?

In this step we are developing a representative sample of different decision makers which identifies the characteristics and properties of a purchase on which decisions are made along with the customer attributes that will be used to describe the decision makers. Each constituent of this sample is called a ▶ micro-segment.

The uniqueness of a micro-segment is that when determining which of the alternative offers are to be bought, the decision makers it represents demonstrate a similar level of interest in a specific set of features, with the features being the characteristics and properties of 'what' is bought, 'where' it is bought, 'when' it is bought and 'how' it is bought as appropriate to the micro-segment. To this is added the descriptors that explain who the micro-segment represents along with an estimate of the volume or value they account for in the defined market.

The principle behind this step is that by observing the purchase behaviour of decision makers and understanding the key constituents of this behaviour, we have a platform for developing a detailed understanding of their motivations. It is, therefore, a critical link with the next step of the segmentation process, which looks at why decision makers select the particular products and services they specify. This, in turn, becomes the basis on which the segments are formed.

Essentially, this step involves identifying all the different purchase combinations that take place in a market made up of the features different customers see as key to making their decision between competing offers. A simple format for capturing this information appears in Figure 3.23.

Micro-segment	1	2	3	4	5	6	7	8	9	10
What is bought										
Where										
When										
How										
Who										

Figure 3.23: Micro-segments.

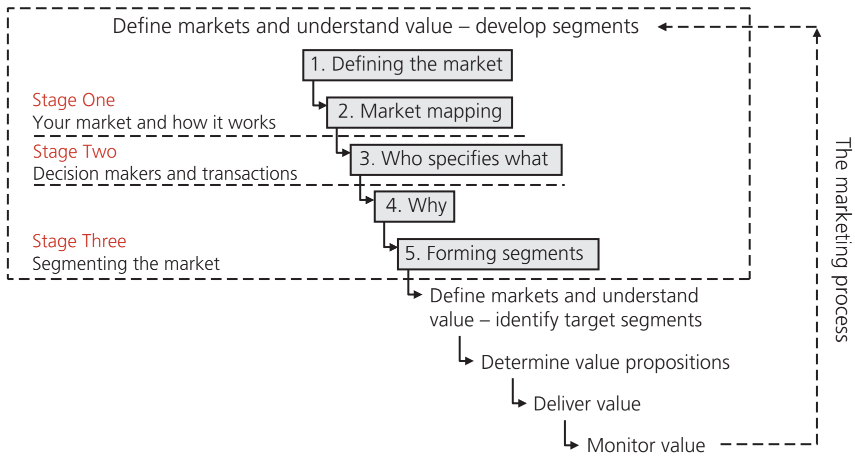


Figure 3.24: The process of developing segments and its position in the marketing process.

Key features could include such principal forms as size, colour, specific type of product/service, add-ons, supporting services, branded, unbranded, and so on, along with the channels used, the preferred timing of purchases (when) and how it is bought, such as cash or credit. Next, it is important to describe who behaves in each particular way using relevant descriptors such as demographics. For industrial purchases this might be standard industrial classifications, size of firm, and so on, whereas for consumer purchases this might be socio-economic groups such as A, B, C1, C2, D and E or stage in the lifecycle, or age, sex or geography. Although in Figure 3.23 there are only ten micro-segments, it is normal in most markets for companies to identify around 20–30 micro-segments, occasionally more. Remember, these micro-segments are actual decision makers and purchase combinations that take place in a market.

With Stage 2 complete we can now progress to the final stage of developing segments. This can be seen in Figure 3.24, a repeat of the process summary presented in Figure 3.16.

Before continuing with the process, it must be pointed out that segmentation can and should be carried out at all major leverage points on the market map, not just at the final user junction as in the example referred to earlier (Figure 3.20).

Stage 3 – Segmenting the Market

Why?

For this penultimate, and most difficult, step each purchase combination has to have a brief explanation of the reason for this particular type of behaviour. In other words, we need to list the benefits sought, and it is often at this stage that an organization needs to pause and either commission market research or refer to its extant database of previous market research studies.

Forming segments

To summarize, it is clear that no market is totally homogeneous and consists of a number of different purchase combinations (see Figure 3.25).

To form meaningful segments we first have to understand these different purchase combinations by the needs that they are satisfying (see Figure 3.26).

However, as it is impracticable to deal with more than between seven and ten market segments, a process has to be found to bring together or cluster all those micro-segments that share similar or approximately similar needs (see Figure 3.27).

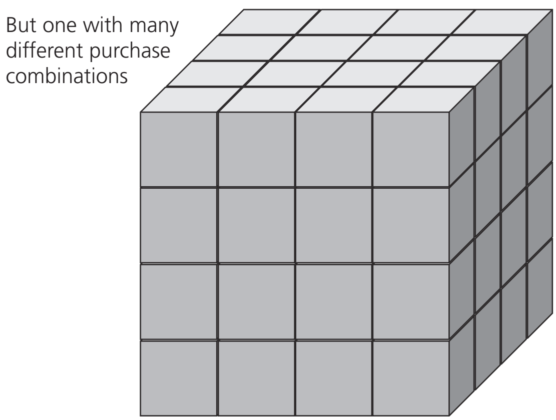


Figure 3.25: An undifferentiated market.

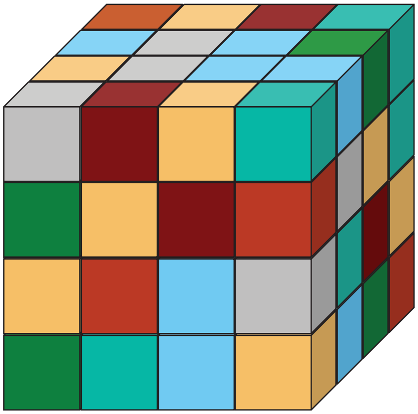


Figure 3.26: Different needs in a market.

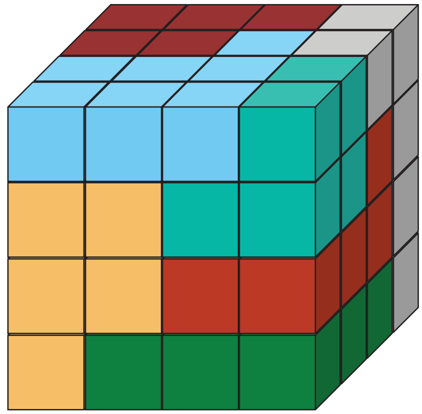


Figure 3.27: Segments in a market.

Understand market segmentation
• Not all customers in a broadly-defined market have the same needs. • Positioning is easy. Market segmentation is difficult. Positioning problems stem from poor segmentation. • Select a segment and serve it. Do not straddle segments and sit between them: 1. Define the market to be segmented and size it (market scope). 2. Determine how the market works and identify who makes the decisions (market mapping). 3. Develop a representative sample of decision-makers based on differences they see as key (including what, where, when and how), note who they are (demographics) and size them. 4. Understand their real needs (why they buy, the benefits sought). 5. Search for groups with similar needs.

Table 3.3: Understand market segmentation.

Once the basic work has been done in describing micro-segments, that is Steps 3 and 4, any good statistical computer program can carry out cluster analysis to arrive at a smaller number of segments. The final step also consists of checking whether the resulting segments are big enough to justify separate treatment, are indeed sufficiently different from other segments, whether they have been described sufficiently well to enable the customers in them to be reached by means of the organization's communication methods and, finally, whether the company is prepared to make the necessary changes to meet the needs of the identified segments.

Before summarizing the process of market segmentation, it will by now be clear that market segmentation is fundamental to corporate strategy. It is also clear that, since market segmentation affects every single corporate activity, it should not be just an exercise that takes place within the marketing department, and has to involve other functions. Finally, the most senior levels of management must lead this initiative if their organization is to be truly market or customer need driven.

Table 3.3 is a summary of what we have discussed so far. It is obvious that there will be very few markets in the world where all customers have the same needs. Also, once market segmentation has been carried out, positioning products and services to meet the different needs of the different segments is comparatively easy. The difficult bit is segmenting markets. The third point is that it is vital to focus on serving the needs of the identified segments, while it is dangerous to straddle different segments with the same offer. The photocopier example was only one example of thousands of well-known companies that have suffered from this mistake as markets began to break into segments. The computer industry during the 1980s and 1990s is also replete with examples of this mistake.

The process of developing segments itself consists of five steps. One, be clear about your market and understand how it works. This involves defining the market, drawing a market map and identifying the decision makers. Two, for these decision makers list the different purchase combinations that occur, covering what is bought, where, when and how; and who these decision makers are, using descriptors such as demographics and location. Three, list who the customers are for each of these different purchase combinations. Four, list why they buy, especially the benefits sought. Five, finally, search for groups with similar needs. These will be the final market segments.

Market structure and market segmentation are the heart and soul of marketing (see Figure 3.28). Unless an organization spends time on market segmentation driven from the board downwards, it is virtually impossible for it to be market driven, and in any organization that isn't market driven the marketing function will be ineffective, or at best will spend its time trying to promote and sell products or services that are inappropriate for the market. The figure describes in more detail each of the important steps for developing segments in the market segmentation process and it would be beneficial to study it in some detail.

1. Define the market

* What, where, when and how

2. Market mapping

1. Constructing the distribution and value added chain that exists between the final users and suppliers in the defined market.
2. Allocating the volumes or values dealt with by each part of the distribution and value added chain.
3. Identifying where decisions are made about competing products and services and the amount they are responsible for with their decision making.
4. Selecting a key group of decision makers to be segmented. In most cases this first takes place with the final users, if sufficiently important. Separate projects may be required for decision makers who perform different roles in the market.
5. Taking the opportunity to test any current views on how the market splits into segments (preliminary segments). This is purely optional and will not prejudice the outcome in any way.

3. Who specifies what*

1. Developing a sample of decision makers (micro-segments) who represent the market as a whole. Drawn up based on differences between them in terms of the characteristics and properties of a purchase they use to discriminate between alternative propositions (Key Discriminating Features). This can be the random sample in a research project.
2. Profiling each micro-segment with attributes that describe who they are.
3. Attaching a size to each micro-segment.

4. Why

1. Understanding the motivations that lie behind the choices made by customers, including the role of price. As customers only seek out features regarded as key because of the underlying needs these features are satisfying (Decisive Buying Criteria), determine the benefits delivered by their Key Discriminating Features, both on their own and as a package.
2. Indicating the relative importance of all the identified Decisive Buying Criteria (including price) to each other for individual micro-segments (relative importance can be illustrated using tick-marks or stars, or by adopting a numerical rating scheme). Ensure that the relative importance of 'price' reflects how readily customers will give up their Key Discriminating Features and associated benefits for a cheaper price.

5. Forming segments

1. Merging micro-segments that are similar to each other based on the importance of their Decisive Buying Criteria to form clusters of like-minded decision makers.
2. Consolidating for each cluster the profiling attributes and sizes linked to the micro-segments it now represents.
3. Applying the segment reality check:
   - is each cluster of sufficient size to justify developing a specific proposition for it and taking this into the market?
   - is the proposition required by each cluster sufficiently different from that required by other clusters?
   - is each cluster reachable through distribution channels the company can use and for communication purposes?
   - is the company capable of adapting itself to serve them?

Project scope:

1. *Geographic area:* If international, ensure that the stage of market development, the available routes to market and the pattern of marketing activity are all the same or at least very similar to each other.
2. *Purpose of the purchase:* Described in terms of a customer need which covers the 'aggregation of all the products and services that customers regard as capable of satisfying the same need'.
3. *Practical considerations:* If necessary, refine 1 and 2 to ensure the scope is meaningful to the company.

} *Size*

Figure 3.28: The market segmentation process summary – developing segments.

To see the details behind each stage, read *Market Segmentation: How to Do It and How to Profit from It* (McDonald and Dunbar, 2012).[1]

Professional market segmentation is hard work and time-consuming, but it is also hugely rewarding and is pivotal to a successful marketing strategy.

There follows a quick segmentation exercise (thanks to Dr Brian Smith[11] of Pragmedic and a Visiting Fellow at the Open University Business School). This will quickly produce a very rough segmentation of your market, but it is no substitute for the proper, more detailed and accurate process described above, as the results will only ever be approximate.

Quick market segmentation solution

- Write down the main benefits sought by customers.
- Hygiene factors are benefits that any product or service must have to be acceptable in the market.
- Try to ignore these.
- Motivators are those benefits that contribute towards the customer's decision about which product to buy.
- Take the 'motivators' and choose the two main ones.
- Draw two straight horizontal lines and make an estimate of the percentage of customers at each end. So, for example, if service level is a key motivator of what is bought, see below:

60% ______________________ 40%

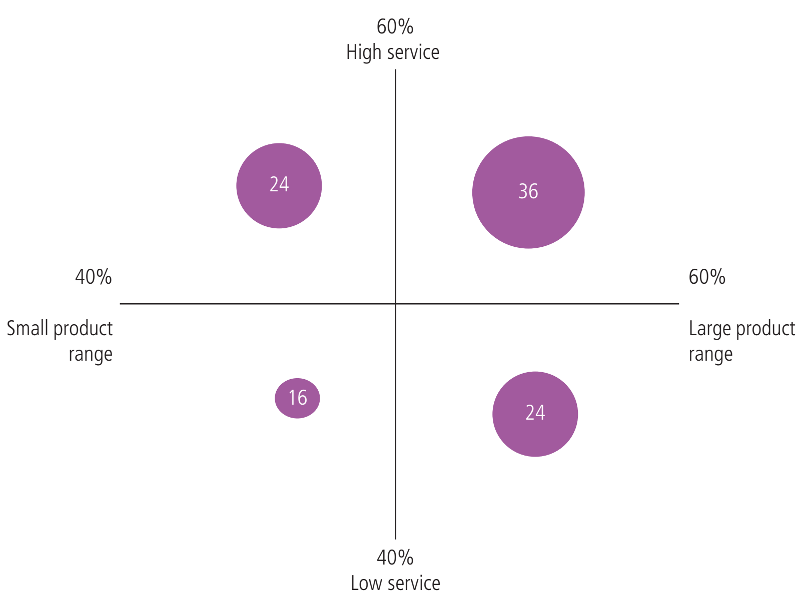
Low service   High service

- Likewise, if the breadth of the product range is a key motivator of what is bought, see below:

60% ______________________ 40%

Small product range   Large product range

- Take the left hand point of the first horizontal line and drag it over the second horizontal line to make a cross as shown here:



- Starting at the top, and moving in a clockwise direction, multiply 60% by 60% to give 36% (see first circle).
- Then multiply 60% by 40% to give 24% (see second circle).
- Then multiply 40% (the bottom of the vertical axis) by 40% to give 16% (see third circle).
- Lastly, multiply 40% by 40% to give 16% (see fourth circle).
- The circles represent segments in the market.

Interpretation

- The first segment (36%), the biggest segment, requires both high service and a large product range.
- The second segment (24%) prefers a large product range and is less interested in service.
- The third segment (16%), doesn't care much about either a large product range or service.
- The fourth segment (24%) prefers good service and is less interested in a large product range.
- Although not essential, you might consider giving each segment a name.

Action

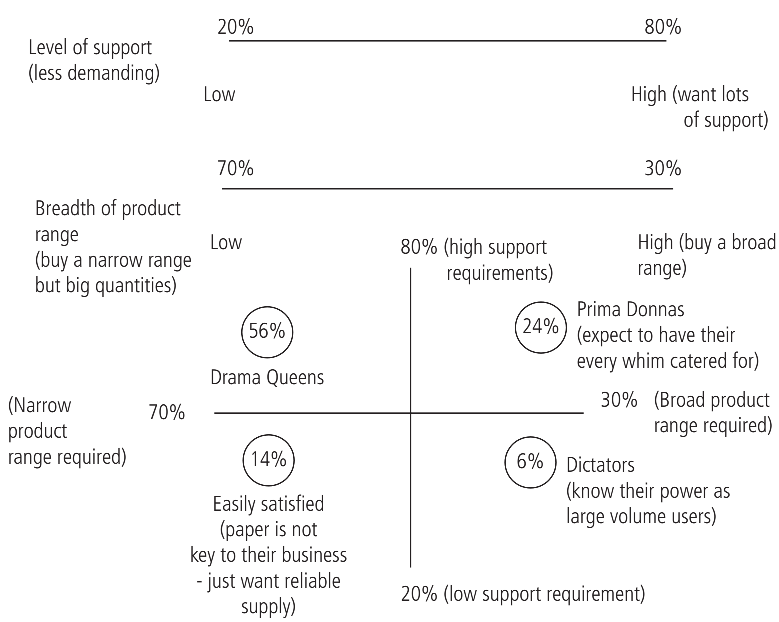
- Ensure your 'offer', including the product, price, service and promotion, reflects the differing needs of each segment.

Example

- An example of segmentation of the A4 paper market follows. Please note that if, as in the case of the A4 paper market, there is one very large segment (in this case 56%), the exercise can be repeated for just this large segment, resulting in seven segments in total.

Example = copier paper

- *Service delivery* – fast, paper always 'there': point of delivery availability of products; service levels.
- *Product fit for purpose* – high quality print finish for colour copiers; consistency of quality; paper that doesn't screw up in the machine; print definition; no waste.
- *Environmental factors* – recyclable.
- *Level of support* – delivered in small lots; consignment stock; easy ordering [on-line]; delivered to difficult locations.



LOOKING TO THE FUTURE

One final, but crucial, step remains in this part of the marketing audit.

The essence of this stage is to revisit the market map, and consider in what ways it might be affected by e-commerce. Reconfiguring the market map involves examining the current market map, and redrawing it to take account of various anticipated effects of e-commerce.

The resulting vision of how the industry could change as a result of e-commerce presents the organization with choices as to how to position itself in the future industry structure and how to manage the transition period. Here is a list of options based on our research of how the market map might be reconfigured.

1. *Disintermediation.* As with other IT-enabled channels such as call centres, e-commerce can enable a link to be removed from the market map, by removing intermediaries whose primary function of information transfer can be more effectively performed using the Internet. An example is the direct sales of greetings cards to the public by a card publisher, thereby bypassing the retailer.
2. *Partial channel substitution.* This forms a halfway house towards disintermediation, in which an intermediary's role is reduced but not eliminated, through some of its value being provided remotely by the supplier to the intermediary's customer. This is the model adopted by a card manufacturer in its relationship with retailers, where its website is supplementing its agent network rather than replacing it. Similarly, a drinks manufacturer is using data gleaned from its information exchange with distributors to promote directly to retailers, providing 'pull-through' demand, which the distributors perceive as of mutual benefit.
3. *Reintermediation.* In some cases, a previous intermediary is replaced by a new online intermediary, rather than bypassed, or an intermediary appears between two types of organization that previously dealt with each other directly. At the time of writing, a groceries manufacturer is having to define its strategy with respect to the various business-to-business exchanges, or e-hubs, which are appearing in its industry to link retailers to manufacturers. Similarly, the finance portals such as Moneysupermarket.com are forming influential intermediaries between manufacturers of financial products and the consumer.

Predicting what reintermediation will occur is particularly difficult, as the possibilities are numerous. Will a given relationship – say, between CTN (confectioners, tobacconists and newsagents) stores and their suppliers – be a direct one? If so, will the shops buy from a range of suppliers' websites, or will the suppliers respond to tender requests provided electronically by shops? Or will there be a new intermediary acting as a marketplace between the two? Possibilities can be placed in an approximate order, from a supplier's website (such as Japan Airlines, which puts out open invitations to tender to suppliers) at one extreme, to a vendor's website (such as *Harvard Business Review*, which provides an online version at a cost) at the other. Neutral marketplaces are midway between the two. An example is an auction site, which is tied neither to the buyer nor to the seller. Somewhat closer to the vendors are intermediaries such as Broadspeed, which passes on leads to a local car dealer. A more buyer-oriented intermediary is TPN Register, a prototypical e-hub which has achieved considerable scale: set up by a consortium of buyers, it acts to ensure that they gain low prices as well as transaction-cost efficiencies through economies of scale.

Our research suggests that which of these possibilities becomes the dominant trading mechanism in a given relationship appears to depend on the number of vendors and buyers, and the relative power of suppliers and buyers. Where there are few buyers and many suppliers, or buyer power is great, the market will tend towards either individual buyer websites or buyer-oriented intermediaries such as the Covisint trading platform set up by Ford, General Motors and Daimler Chrysler. Conversely, a small number of suppliers selling to large numbers of customers will have the power to control the market through their own websites or through supplier-oriented consortia. Large numbers of both suppliers and buyers will tend to use a neutral marketplace to reduce the search costs of both parties, though a supplier with a particularly strong brand and/or product differentiation, such as *Harvard Business Review*, may choose not to participate in such marketplaces.

To illustrate this thinking about reintermediation, consider Figure 3.29, a simplified value map from the groceries market.

The current market structure, shown in black, involves manufacturers reaching consumers via a combination of the major multiple supermarkets, independent stores and CTN stores. Our analysis suggests that because the major multiples are few in number and hold considerable buying power, their relationship with manufacturers will either continue to be a direct one, using purchasing systems dictated by the multiples, or will be mediated by a buyer-oriented intermediary, as indicated in the potential future structure shown in blue. However, the many-to-many relationship between manufacturers and independents or CTNs needs a more neutral intermediary, such as is provided currently by warehouses and wholesalers. We predict a similarly neutral online intermediary succeeding here, either through a new entrant start-up or through media addition by a wholesaler. Likewise, the relationship between manufacturers and suppliers is likely to include a neutral spot market for commodity ingredients. These predictions appear consistent with industry developments to date.

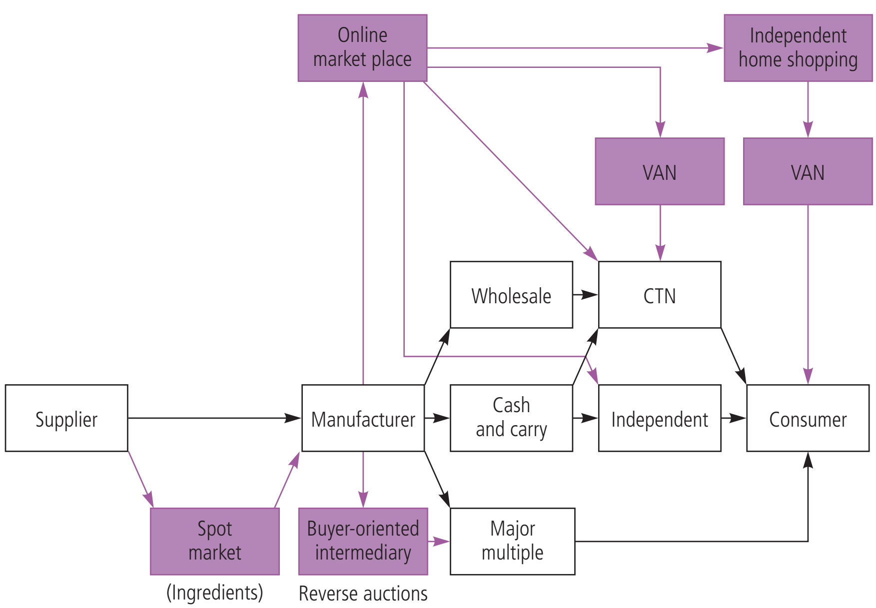


Figure 3.29: Simplified value map for the groceries market.

To reconfigure the market map, therefore, one needs to consider the potential effect of each of our three broad changes in turn. In each case, one needs to:

- Sketch the effect of the possible change on the market map.
- If the effect is positive for some segments, incorporate the transformation in a revised market map (say, for three years hence).

WHY MARKET SEGMENTATION IS VITAL IN MARKETING PLANNING

In today's highly competitive world, few companies can afford to compete only on price, for a product has not yet been sold that someone, somewhere, cannot sell cheaper – apart from which, in many markets it is rarely the cheapest product that succeeds anyway. This is an issue we will return to in Chapter 9 dealing with the pricing plan. What this means is that we have to find some way of differentiating ourselves from the competition, and the answer lies in market segmentation.

The truth is that very few companies can afford to be 'all things to all people'. The main aim of market segmentation as part of the planning process is to enable a firm to target its effort on the most promising opportunities. But what is an opportunity for firm A is not necessarily an opportunity for firm B, depending on its strengths and weaknesses. The whole point of segmentation is that a company must either:

- define its markets widely enough to ensure that its costs for key activities are competitive, or
- define its markets in such a way that it can develop specialized skills in serving them to overcome a relative cost disadvantage.

Both have to be related to a firm's *distinctive competence* and to that of its competitors.

All of this should come to the fore as a result of the marketing audit referred to previously and should be summarized in SWOT analyses. In particular, the differential benefits of a firm's product or service should be beyond doubt to all key members of the company.

Even more important than this, however, is the issue of marketing planning and all that follows in this book. It is worth repeating why market segmentation is so important. Correct market definition is crucial for:

- share measurement
- growth measurement
- the specification of target customers
- the recognition of relevant competitors
- the formulation of marketing objectives and strategies.

To summarize, the objectives of market segmentation are:

- To help determine marketing direction through the analysis and understanding of trends and buyer behaviour.
- To help determine realistic and obtainable marketing and sales objectives.
- To help improve decision making by forcing managers to consider in depth the options ahead.

SEGMENTATION CASE HISTORIES

This chapter concludes with two case histories to illustrate how superior profitability results from successful market segmentation.

CASE STUDY

CASE STUDY 1 – SODIUM TRI-POLY PHOSPHATE!

Sodium Tri-Poly Phosphate (STPP) was once a simple, unexciting, white chemical cleaning agent. Today, one of its uses is as the major ingredient of a sophisticated and profitable operation, appearing under many different brand names, all competing for a share of what has become a cleverly segmented market.

Have you ever wondered how the toothpaste marketers classify you in their segmentation of the market? The following chart, adapted from R. Haley's 'Benefit segmentation: a decision-oriented research tool' (*Journal of Marketing*, Vol. 32, July 1968), which presents the main segments, may assist you.

	Segment Name	Worrier	Sociable	Sensory	Independent
Profile	*Demographic*	C1 C2	B C1 C2	C1 C2 D	A B
		25-40	Teens	Children	35-40
		Large families	Young smokers		Male
	Psychographic	Conservative: hypochondriacs	High sociability: active	High self-involvement: hedonists	High autonomy: value orientated
What is bought, where, when and how	*Product examples*	Signal	Macleans	Colgate	Own label
		Mentadent P	Ultrabrite	Aquafresh	Small tubes
	Format	Large canisters	Large tubes	Medium tubes	Independent
	Features	Health properties	Whitening properties	Flavouring	Quarterly
	Outlet	Supermarket	Supermarket	Supermarket	
	Purchase frequency	Weekly	Monthly	Monthly	
Why it is bought	*Benefits sought*	Stop decay	Attract attention	Taste	Functionality
Price paid		Medium	High	Medium	Low

	Segment Name	Worrier	Sociable	Sensory	Independent
Percentage of market		50%	30%	15%	5%
Potential for growth		Low	High	Medium	Nil

Note: 'C1', 'C2', and so on, appearing in the demographic profiles of each segment represent socio-economic groups which were in use in the UK until 2001, now replaced in official statistics by eight analytic classes numbered from 1 through to 8. 'Signal' and 'Mentadent P' are trade marks of Lever Fabergé; 'Macleans' and 'Aquafresh' are trade marks of GlaxoSmithKline; 'Ultrabrite' and 'Colgate' are trade marks of Colgate-Palmolive.

CASE STUDY

CASE STUDY 2 – GLOBALTECH (SERVICE SEGMENTATION)

SUMMARY

This case history describes the use of market segmentation to assist in the development of a service product. Customer requirements were captured via qualitative research. The segmentation was completed through the use of quantitative research. The result was a set of segments that enabled the development of a new approach to delivering service while improving customer satisfaction. *GlobalTech* is the fictitious name of a real company marketing high-tech and service products globally. Customers are counted in hundreds of thousands. The markets are mainly business-to-business with a few very large customers buying thousands of items. Service is a major revenue stream measured in billions of dollars. The lessons learnt could be of interest to any organization having to care for large numbers of customers.

BACKGROUND

A Failed Segmentation

An internal GlobalTech team tried to complete a marketing audit early in 2000. This included market definition, market segmentation and quantification. Each product division conducted their audit separately. They used mainly brainstorming techniques to define their markets and to produce the data required.

LESSON 1

Markets transcend your internally defined product divisions. Therefore, it is best to understand the markets and monitor your overall performance in those markets. To reshape market information to meet the needs of internal reporting will lead to misinformation.

On completion, the results were compared across the divisions. It rapidly became apparent that each division addressed almost all the markets. However, the market definitions they produced were different, with significant bias towards just the products they offered. Similarly, the segments each division identified were in conflict with the outputs from the other divisions.

On reflection, it was agreed that the results were unreliable. They could not be used to help shape future strategies or marketing investments.

(*Continued*)

GlobalTech was now in the uncomfortable situation of being in a market information vacuum. Any confidence they had had in their understanding of the market had been destroyed. Consequently the decision was taken that all future market analysis and understanding tasks would be supported by appropriate investments in market research.

LESSON 2

Do not rely on the internally gathered opinions of your sales and marketing staffs to define markets and identify customer requirements and attitudes. Do invest in the necessary market research to provide a reliable segmentation and support for strategy and product development.

First market segmentation. The following year the segmentation was redone, supported by extensive qualitative and quantitative market research. The objective was to understand and group into segments the product buyers in the overall market.

The qualitative study produced a very clear picture and definition of the markets addressed by GlobalTech. It also provided the customers' view of the benefits they sought from the products and the differences in their attitudes towards their suppliers. The questionnaire for the quantitative study was based on the results of the qualitative study. The result was seven clearly defined segments.

This enhanced understanding of the market assisted with hardware and software products but did not address service products or customer satisfaction and loyalty issues.

The Internal Need

At the dawn of the 21st century, the market lifecycle had matured. All but the more sophisticated products were perceived as commodities. Consequentially, the opportunities for effective product differentiation had diminished. GlobalTech, in common with its competitors, was finding that customers were becoming increasingly disloyal.

For many years, product churns and upgrades from existing customers had accounted for some 70 per cent of GlobalTech's product revenues. Service and exhaust revenues* almost equalled total product revenues. Service was perceived to be a key influencer of loyalty. But the costs of delivering service were becoming unacceptable to customers. Concurrently, service pricing was coming under increasing competitive pressures.

The challenge was to increase loyalty while achieving a step function improvement in margins. Thus it was decided to invest in a better understanding of the service market as an enabler to delivering cost-effective differentiation and loyalty. This case history covers the project from inception to implementation.

The Segmentation Project

Buy-in

The GlobalTech main board director responsible for customer service sponsored the project. This was a critical prerequisite, as the outcome would have a significant impact on the organization, its processes and behaviours.

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* Exhaust revenues are those revenues that follow on, almost automatically, from an initial product sale. These would normally include service plus training, consultancy, consumables, supplies and add-ons, etc.

Similarly the project team included key members of service, marketing and finance to ensure buy-in. However, at that time, it was deemed inappropriate to include representatives from all but two of the countries due to travel implications, costs and resource impacts. In retrospect this was not a good decision.

LESSON 3

Try to anticipate the scale of organizational change that may result from a major segmentation project. Then ensure the buy-in planned from the start of the project embraces all those who will eventually have a say in the final implementation.

Business Objectives

The project team agreed the overall business objectives as:

- To develop strategies for profitable increase in market share and sustainable competitive advantage in the service markets for GlobalTech's products.
- To identify opportunities for new service products and for improving customer satisfaction within the context of a robust customer needs segmentation, which can be readily applied in the marketplace.
- To identify the key drivers of loyalty so that GlobalTech may take actions to increase customer loyalty significantly.
- To provide the information required to help develop a new and innovative set of service products designed and tailored to meet differing customer requirements while significantly reducing internal business process costs.

Results from the qualitative study. The output from the qualitative study was a 93-page report documenting the results, in line with the desired research objectives. Some of the more surprising aspects were supported by verbatims. A key output was the polarization of very different attitudes towards service requirements that some buyers had in comparison with others. For example:

- Some wanted a response within a few hours, whereas many others would be equally happy with next day.
- Some wanted their staff thoroughly trained to take remedial actions supported by a specialist on the phone.
- Others did not want to know and would just wait for the service provider to fix the problem.
- Some wanted regular proactive communications and being kept up to date.
- Others wanted to be left alone.
- Some would willingly pay for a premium service, under a regular contract, while others would prefer to take the risk.

The attitudes of professional buyers, procuring on behalf of user departments, were consistently different from those of the user departments.

Results from the quantitative study. The output from the quantitative study was extensive. Much of the output was detailed demographic data, opportunities information and competitive positioning comparisons. However, the focus was on a fairly extensive executive summary for internal communications within GlobalTech. What follows are summarized extracts from those outputs.

The segments. Six market segments were identified as a result of iterative computer clusterings. Initially the clustering routines had identified more segments but by careful analysis

(*Continued*)

these were reduced to what was decided to be the most manageable level. Some previously very small segments were merged with very similar larger segments. A summary of the six concluding segments follows.

Koala Bears

28% of Market

Preserve their assets (however small) and use, say, an extended warranty to give them cover. Won't do anything themselves, prefer to curl up and wait for someone to come and fix it.

Small offices (in small and big companies).

Teddy Bears

17% of Market

Lots of account management and love required from a single preferred supplier. Will pay a premium for training and attention. If multi-site, will require supplier to effectively cover these sites. (Protect me.)

Larger companies.

Polar Bears

29% of Market

Like Teddy Bears except colder! Will shop around for cheapest service supplier, whoever that may be. Full third party approach. Train me but don't expect to be paid. Will review annually (seriously). If multi-site will require supplier to effectively cover these sites.

Larger companies.

Yogi Bears

11% of Market

A 'wise' Teddy or Polar Bear working long hours. Will use trained staff to fix if possible. Needs skilled product specialist at end of phone, not a bookings clerk. Wants different service levels to match the criticality of the product to their business process.

Large and small companies.

Grizzly Bears

6% of Market

Trash them! Cheaper to replace than maintain. Besides, they're so reliable that they are probably obsolete when they bust. Expensive items will be fixed on a pay-as-when basis – if worth it. Won't pay for training.

Not small companies.

Andropov Big Bears

9% of Market

My business is totally dependent on your products. I know more about your products than you do! You will do as you are told. You will be here now! I will pay for the extra cover but you will. . .!

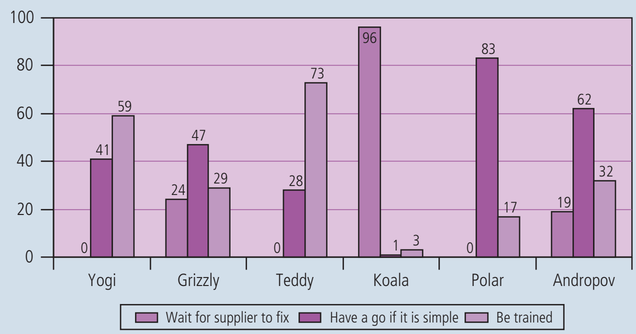
Not small or very large companies.

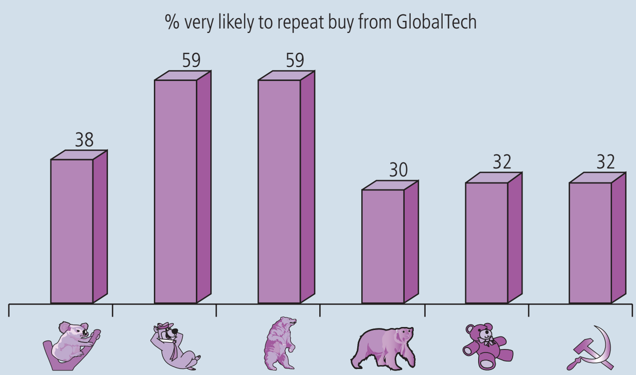
Polarizations in Attitude

The computer clustering generated the segments by grouping customers with similar attitudes and requirements. This resulted in some marked differences in attitude between segments. As illustrated below, the Koalas really did not want to know about being trained and having a go. But the Teddies, Yogis and Polars had an almost opposite attitude.

Satisfaction and loyalty. GlobalTech was measuring customer satisfaction for use both locally, as a business process diagnostic tool, and globally, as a management performance metric. These satisfaction metrics were averaged across all customers, both by geographic business unit and by product division to meet internal management reporting requirements.

However, the outputs from the quantitative study clearly showed that these traditionally well-accepted metrics were, in fact, almost meaningless. What delighted customers in one market segment would annoy customers in another, and vice versa. To make the metrics meaningful, they had to be split by key criteria and the market segments.





Loyalty was obviously highest where GlobalTech's 'one size fits all' service deliverable coincidentally best matched a segment's requirement, as illustrated.

Correlation between loyalty and customer satisfaction. The market lifecycle for many of GlobalTech's products was moving into the commodity phase. Therefore, not surprisingly, customers were becoming less loyal.

(*Continued*)

Each percentage point increase in loyalty translated into almost the same increase in market share. Each percentage point in market share added many millions of dollars of gross revenues. The cost of reselling to a loyal customer was about one-sixth the cost of winning a new customer. Consequently, each percentage point increase in loyalty had a significant impact on the bottom line.

Because of this, the quantitative study included correlating the key drivers of satisfaction and loyalty within each market segment. The qualitative study identified some 28 key customer requirements of their service provider. The quantitative study prioritized these to provide a shorter list of 17 common requirements. The correlation exercise reduced this to only two requirements that drew a significant correlation between satisfaction and loyalty:

- providing service levels that meet your needs
- providing consistent performance over time.

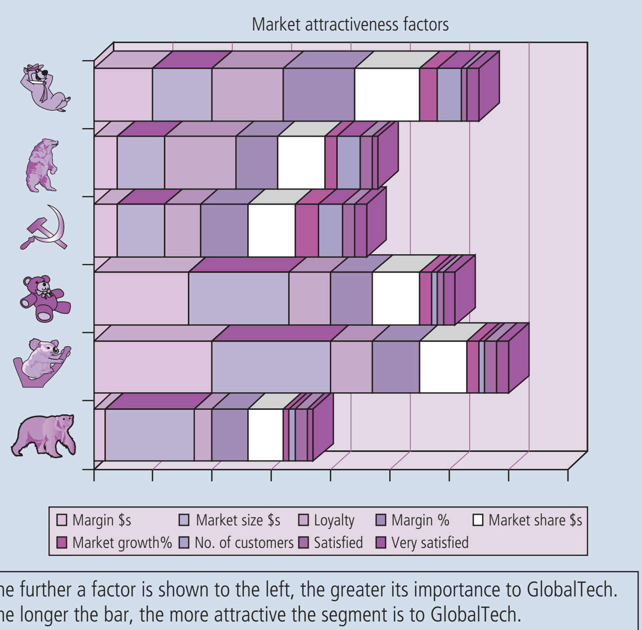
Although GlobalTech was achieving the second, it was really only delivering the first in two of the market segments.

Segment Attractiveness

As an aid to deciding where best to invest, a chart of segment attractiveness was produced using attractiveness factors determined by GlobalTech. Demographic data from the quantitative study was combined with internal GlobalTech financial data.

Each factor was weighted to reflect the relative importance to GlobalTech. This highlighted quite a few issues and some opportunities. For instance, the highest margins were coming from some of the least loyal segments.

Market Attractiveness Factors



Competitive positioning. Fortunately for GlobalTech, its competitors did not appear to have an appreciation of the market segments or the differing requirements of their customers. They were also mainly delivering a 'one size fits all' service offering. However, there were some noticeable differences in their offerings. These resulted in each major competitor being significantly stronger in just one or two market segments where their deliverable best matched the segment needs.

The quantitative study provided detailed rankings of the decisive buying criteria (DBCs) and critical success factors (CSFs) for each market segment. These were to prove invaluable during the phase of designing the service products and developing the strategy to achieve competitive advantage.

- *DBCs* (decisive buying criteria) are the needs (benefits) buyers are seeking to have satisfied by their choice of product or service.
- *CSFs* (critical success factors) are the constituents of the other required to deliver each benefit (DBC).

Reachability. Key to GlobalTech successfully implementing any strategies or communications that were to be market segment based would be being able to identify each customer by segment. As part of the quantitative study, two statistical reachability tasks were completed.

A sampling of internal GlobalTech databases showed that there was sufficient relevant data to achieve better than 70 per cent accuracy, using statistical imputation methods, to code each customer record with its market segment. This was considered to be good enough to enhance marketing communications measurably, but might not be sufficiently accurate to ensure always making the most appropriate offer. Statistical analysis identified four questions that would provide acceptable accuracy in segment identification. These questions could then be used during both inbound and outbound call centre conversations until such time as all customers had been coded.

The recommendation was to use both methods in parallel so that accuracy would improve over time. Also, the coding of larger customers should be given a priority.

LESSON 4

Understanding the different market segments helps in designing the required offers. But do not get hung up on reachability. It is not essential to code every customer to the right segment from day one. Where you are not really sure, let them see different offers and so position themselves.

Similarly, be willing to accept that within a large organization some buyers may fall into different market segments, though the difference will only be on one or perhaps two buying criteria rather than across all the buying criteria.

Strategy Development and Implementation

Market understanding and strategy development. The challenge now was for the project team to absorb and understand all the findings from the two research studies. The team then had to turn that understanding into realizable strategies. To achieve this, a workshop process covering opportunities, threats and issues (OTIs) was used.

(*Continued*)

Briefly, the process involved an extensive, but controlled, brainstorming session followed by a series of innovative strategy development workshops.

A facilitator took the team systematically through every piece of relevant information available. Using brainstorming, the team tried to identify every conceivable opportunity, threat or internal issue associated with each item of information. The information was also then tested against a predetermined list of business behaviours and processes in an endeavour to entice additional and creative ideas out of the brainstorming. Using the decisive buying criteria and critical success factors from the market model, strengths and weaknesses were added, thus turning the process into a SWOT. Like ideas were merged and de-duplicated.

Each idea was given two scores in the range of 1–9. The first ranked the probable financial impact, the second ranked the probability of success. The ideas were then grouped by like activity and where they had the same or an overlapping financial impact. This ensured that double counting was eliminated and that opportunities and threats were offset as appropriate. Any one group of ideas would take on the highest single financial impact score and a reassessed probability of success score. If the resolution of an internal issue was a prerequisite for capturing an opportunity or overcoming a threat, then the issue plus associated costs and resources was included in the same group as the opportunity or threat. The norm was for a single issue to be attached to many groups. The groups were named and then ranked both by financial impact and probability of success. This provided a prioritized shortlist of imperatives that should deliver the maximum realizable benefits to both GlobalTech and its customers. Iterative discussions developed this into an overall strategy with a number of prioritized sub-strategies. Each sub-strategy was supported by a documented description of the opportunity. At this stage encouragement was given to creating innovative, yet simple, implementation options that would maximize the chances of success. Each implementation option was supported by market, revenue and organizational impact data, associated issues, resources, costs, and required control metrics. Board members were involved in an option selections and investment approvals process. Finally, the implementation programmes and project plans were created.

The strategy. The overall recommendation was to create a set of service deliverables tailored to the individual needs of each segment. These would be complemented by a set of premium add-ons that could be offered to the appropriate segments. By focusing on business process simplification, during the design of the offering for each segment, redundancy was eliminated.

The objective of each offering was to increase customer satisfaction significantly, with an emphasis on those items that would most positively impact loyalty. Some offerings were quite different from others, both in terms of the deliverable and the internal processes that made it possible. This differentiation was also intended to create a measurable competitive advantage in a number of the market segments.

A key to the implementation of the project was a recommended change to the customer satisfaction metrics, so that they became an effective diagnostic tool for tuning the ongoing deliverables for each market segment.

Implementation. Throughout the project, the same core team had been intimately involved with each stage of the project. They guided the work and took on board the results.

They delved deeply into the analysis and did their best to understand the markets, their customer requirements and likely competitive impacts. Finally they worked hard at developing the proposed strategies. They thought buy-in had been achieved by being sponsored by a main board director.

The implementation rollout across country boundaries became difficult. Each country wanted their say. They had different views of their customer needs and how things should be done in their country. They did not easily understand or even accept the findings of the research and the meaning of the outputs.

The majority of these internal barriers were eventually overcome. Inevitably there were compromises. These led the project team into believing that not all the market segments would be fully satisfied with the new offerings in all countries.

APPLICATION QUESTIONS

1. Choose a major product or service. What are its features? Identify the benefits (to the customer) of each feature. Identify which of these are differential benefits.
2. If you cannot identify any differential benefits, in what ways could you develop some?
3. For those you have identified, how can they be improved on?
4. Identify your key market segments. How do you describe them?
5. If you cannot identify any distinct segments, how can you begin to identify one or more?

CHAPTER 3 REVIEW

Customers or consumers?

Customers are people who buy from you. Consumers are the users of your products or services – for example, a husband (customer) buys perfume for his wife (consumer). Sometimes the customer is also the consumer. Marketers need to know about the characteristics of both if they are to develop the best 'package' to meet their needs.

Market share

Market share is a key concept in marketing. It is the proportion of actual sales (either volume or value) within a defined market. How the company defines its market is extremely critical.

Try Exercise 3.1

Research shows that there is a direct correlation between market share and profitability.

Critical success factors

Within any given market segment there are critical success factors (CSFs) for winning the business, for example, reliable delivery, acceptable design, low running costs, and so on. It will be essential for the company to establish what these are and how well it compares with its closest competitors, when measured against these factors.

Try Exercise 3.2

Market segmentation

A market segment consists of a group of customers within a market who share a similar level of interest in the same, or comparable, set of needs which can be satisfied by a distinct marketing proposition.

Each segment is sufficiently large to give the company a return for its effort. Members of each segment have a high degree of similarity. The criteria for describing segments must enable the company to communicate effectively with them.

Segmentation can be based on a combination of:

1. Analysis of customer behaviour:
   - What do they buy?
     - value/volume
     - price
     - frequency
     - where they buy/outlet
     - products/services, etc.

Try Exercise 3.3

   - Why do they buy?
     - benefits
     - lifestyle
     - fashion/novelty
     - personality types
     - peer group pressure preferences, etc.

Try Exercise 3.4

2. Analysis of customer characteristics (who they are):
   - customer size
   - socio-economic groups
   - demographic considerations
   - industrial classification
   - cultural/geographic factors.

Try Exercise 3.5

Questions raised for the company

1. Q: Why is market segmentation so important?
   A: Few companies can be 'all things to all people'. Segmentation allows the firm to target its effort on the most promising opportunities.
2. Q: How can we be expected to know our market share?
   A: The more accurately you can define your market segments, the more accurately you will find you can measure your market share. Correct market definition is also critical for:
   - growth measurement
   - specifying target customers
   - recognizing relevant competitors
   - setting marketing objectives and strategies.
3. Q: How can we keep tabs on all our competitors?
   A: You don't have to – just concentrate on your closest competitors and try to ensure that you maintain some differential advantage over them.

EXERCISES

Introduction to Chapter 3 exercises

Exercise 3.1 looks at the most crucial and complex issue in marketing, that is, how a market is defined. Until this is clearly understood, issues such as market share, the identification of target customers and their needs, and even the recognition of competitors, will continuously cause difficulty.

Exercise 3.2 examines critical success factors. Exercise 3.3 provides a technique for auditing industrial goods and services.

Exercise 3.4 introduces another technique, benefit analysis, and this is extended and put into practice in Exercise 3.5, which provides a case study for analysis.

Exercise 3.1 Market definition

Often there is confusion regarding what constitutes a market. Unless such confusion is dispelled from the outset, the whole marketing edifice will be built on sand. However, as so often is the case, what on the surface appears to be a relatively simple task can prove to be extremely testing. Take the example shown in Figure 3.30, which vastly simplifies the problem.

Figure 3.30: Example of market definition.

XYZ Ltd has five major products, A, B, C, D and E, which are sold to five different markets, as represented in Figure 3.30. Virtually all sales are achieved in the shaded areas.

Is this company's market:

a) The shaded areas?
b) The intersection of products A, B and C and markets 2, 3 and 4?
c) Products A, B and C for all markets?
d) Markets 2, 3 and 4 for all products?
e) The entire matrix?

(*Continued*)

Scoring and interpretation for Exercise 3.1

1. It would be possible to define our market as the shaded areas ((a) in the exercise), that is, the product/market area currently served. The problem with this is that it might tend to close our eyes to other potential opportunities for profitable growth and expansion, especially if there is a danger that our current markets may become mature.
2. It is also possible to define our market as the intersection of products A, B and C and markets 2, 3 and 4 ((b) in the exercise). The problem with this is that while we now have a broader vision, there may be developments in product areas D and E and markets 1 and 5 that we should be aware of.
3. To a large extent, this problem would be overcome by defining our market as products A, B and C for all markets ((c) in the exercise). The problem here is that markets 1 and 5 may not require products A, B and C, so perhaps we need to consider product development (products D and E).
4. It is certainly possible to consider our market as all products for markets 2, 3 and 4 ((d) in the exercise). The potential problem here is that we still do not have any interest in markets 1 and 3.
5. Finally, it is clearly possible to call the entire matrix our market ((e) in the exercise), with markets 1 to 5 on the vertical axis and each of products A to E on the horizontal axis. The problem with this is that we would almost certainly have too many markets, or segments, and this could lead to a costly dissipation of effort.

The answer to the conundrum, therefore, is that it is purely a matter of management judgement. Any combinations of (a)–(e) above could be used, as long as there is a sensible rationale to justify the choice.

In addition, remember the following definition of ‘market’:

A market is the aggregation of all the products or services which customers regard as being capable of satisfying the same need.

Remember also the following useful definition of market segmentation:

An identifiable group of customers with requirements in common that are, or may become, significant in terms of developing a separate strategy.

Often, the way a market was selected in the first instance can provide clues regarding how it can be defined. Generally, either consciously or intuitively, a screening process is used to eliminate unsuitable markets and to arrive at those with potential. This screening process often works something like that shown in Figure 3.31.

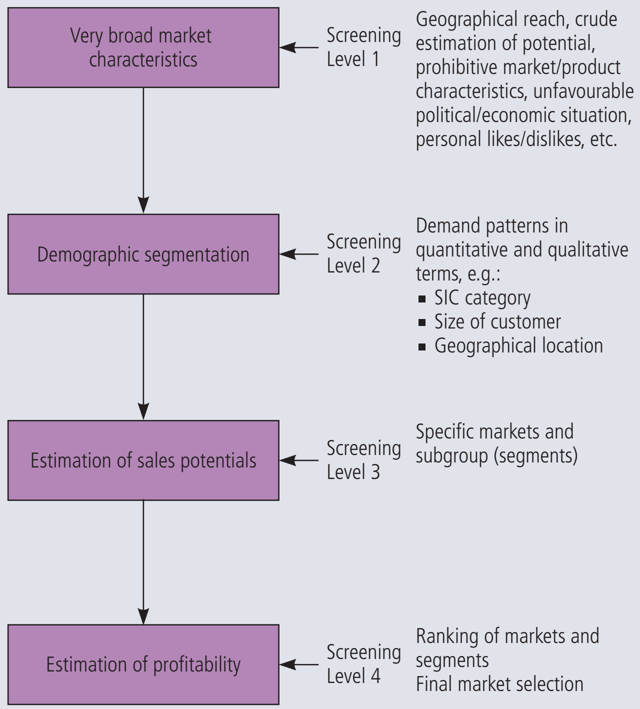


Figure 3.31: Market screening.

Consider one of your current markets and explain:

1. How it came to be chosen
2. How you would define it, so that it is clearly distinct from any other market.

Remember that the crude method outlined above, while working at a very general level, rarely leads to the development of differential advantage, and it is suggested that the other exercises in this chapter should be completed in order to get a better understanding of the central significance of market segmentation in marketing success.

Exercise 3.2 Critical success factors (CSFs)

Critical success factors can vary from one type of business to another, or indeed from one market segment to another. Therefore, it is impossible to be prescriptive about your CSFs, and you will have to draw on the expertise you have about your business and establish which ones are correct for you.

Remember, a CSF is something which helps you to clinch the business. Thus, by definition, if it were absent, your success rate would plummet.

(*Continued*)

Normally there would only be a few CSFs – probably not more than five – although there might be many other factors which contribute to success.

Table 3.4 is an example of the way a firm of quantity surveyors analysed their business.

CSF	Weighting	Score out of 10 (10 = very high standard)	Adjusted score*
1 Reputation for on-time completion	0.5	6	30
2 Track record of quality	0.3	6	18
3 Quality of sales staff	0.2	8	16
Total	1.0		64%

Table 3.4: Critical success factors (1).

*Adjusted score = score out of 10 × weighting factor.

Weighting factors are distributed to each CSF according to their relative importance. In Table 3.4, CSF1 is the most important, but the company only scores 6, just over average. In contrast, on CSF3 the company scores high, but this factor is the least critical of those listed and so the net result is diminished.

The company now repeats this process (Table 3.5), this time focusing on its nearest competitors.

On the evidence in Table 3.5, our company can see that Competitor A, even with a lower quality sales force and a slightly poorer track record, has a competitive advantage because of its ability to complete contracts on time. Similarly, Competitor C is a force to be reckoned with. In contrast, Competitor B has a lot of ground to make up in all areas.

CSF	Weighting	Comp. A score		Comp. B score		Comp. C score	
		Raw	Adjusted	Raw	Adjusted	Raw	Adjusted
1	0.5	9	45	5	25	7	35
2	0.3	5	15	5	15	7	21
3	0.2	6	12	5	10	5	10
Total			72%		50%		66%

Table 3.5: Critical success factors (2).

This technique can be applied to all companies and provides three useful outcomes:

1. It forces people to think about their critical success factors.
2. It provides an overview of relative competitiveness when measured against their main competitors.
3. It highlights the areas where the most effective improvements might be made.

Now try it on your company. See Tables 3.6 and 3.7.

CSF	Weighting	Score out of 10 (10 = very high standard)	Adjusted score*
CSF1			
CSF2			
CSF3			
CSF4			
CSF5			

Table 3.6: Critical success factors (3).

CSF	Weighting	Comp. A score		Comp. B score		Comp. C score	
		Raw	Adjusted	Raw	Adjusted	Raw	Adjusted
CSF1							
CSF2							
CSF3							
CSF4							
CSF5							

Table 3.7: Critical success factors (4).

Exercise 3.3 Market audit – industrial goods and services

Using your own company as the study vehicle, complete the market audit form (Table 3.8) by following these instructions:

Step 1 In column 1, list all those industries that are consumers of your goods or services. Note that there is no need to structure this list, just write them down as they occur to you.

Step 2 In column 2, write the actual turnover figure.

(Continued)

Step 3 In column 3, write down the percentage value of turnover that results from each of the industries.

Step 4 In column 4, indicate whether or not this, when considered from the point of view of profitability, is high or low, by scoring 10 for high, 5 for good, and 1 for low (here, 'profitability' means whatever your company considers it to mean).

Step 5 Using column 5, consider what capacity and skills you have at your disposal to continue supplying each industry – a score of 10 would show that you have considerable capacity, with minimal interference to other products or services; 1 would indicate severe limitations.

Step 6 Using a similar scoring procedure, complete column 6. Ask yourself how confident your company is that it can supply each industry with the right quality and design of goods/services, delivered on time. Are you more confident about some than others?

Step 7 Now consider the market potential (demand) for your output in each of the listed industries. Using column 7, score 10 for high potential and 1 for low.

Step 8 Add the scores you have allocated in columns 4, 5, 6 and 7, and enter them in column 8.

Step 9 Using the information you have put together, identify your key market segments. They ought to be those industries which collected the highest aggregate scores, but for your type of business you might identify other factors that would influence your choice of market. Make a note of these in column 9. In addition, use column 9 to record any particular opportunities or threats presented in each market.

Step 10 Balancing the notes you made in column 9 against the arithmetic calculations (column 8), study the information you have assembled, and select what you regard as the best industrial market. Enter 1 against this in column 10. Continue ranking each industry, using 2 for the next best, 3 for the third, and so on, until column 10 is filled.

Information from this market audit could be used at a later stage, when marketing objectives and strategies are examined (Exercises 6.6 and 6.7).

Exercise 3.4 Benefit analysis

Customers buy products and services because they seek to acquire a range of benefits which go with them. In this sense, all products and services are problem solvers. Thus, customers buy aspirin to solve the problem of headaches, they buy drills because they need holes, they buy convenience foods because they solve the problem of there not being enough hours in the day.

It is essential for providers of products or services to be aware that their output is only saleable for as long as it provides the benefits the customer requires, and for as long as it is seen by the customer to be good value when compared with other possible methods of solving their problems. Once there is a better, cheaper, quicker, tidier, more enjoyable way of putting holes in walls, the drill manufacturer will go the way of the buggy-whip maker. Therefore, it is vitally important to know just as much about the benefits they supply, as it is to know about the products or services themselves.

Standard benefits

These are provided by the product but are not in any way unique – for example, 'the propellant in our aerosol does not damage the ozone layer'. Although in this respect your product might be like all others, not to make customers aware of this standard benefit could imply that you still use environmentally unfriendly materials. Clearly this would be to your disadvantage.

Company benefits

The business transaction links the customer to the company. In turn, this means that there ought to be some benefits to that customer for making that choice. Customers will prefer to deal with companies that provide better customer service, inspire confidence, have a reputation for fair trading policies, and so on. Company benefits are a means of differentiating your products or services from competing ones, if to all intents and purposes they are similar. For example, some banks are trying to establish specific identities to the benefits they supply. Hence there is 'the listening bank' and 'the bank that likes to say yes'. Perhaps eventually there will be 'the bank that is open when its customers want it to be'!

Differential benefits

These are the benefits that only your products or services provide. It is these that give the company its competitive advantage. It is these that must be identified, developed and exploited if the company is to win success. Here are some examples:

- 'We are the only company that provides a genuine 24-hour breakdown service. Therefore, any time you need us, we are there to get you moving again.'
- 'This is the only product on the market with this self-cleaning facility, so you can install it and have no maintenance worries.'

Not every benefit will have equal appeal to all customers, or groups of customers.

However, by talking to them, or carrying out research, it ought to be possible to establish which are the important benefits in their eyes.

It is now possible to prepare a systematic benefit analysis along the lines shown in these examples. See Table 3.9.

(*Continued*)

1	2	3	4	5	6	7	8	9	10
Industry Industry	Actual T/O	% T/O	Profitability L_1 $_{10}H$	Capacity L_1 $_{10}H$ Capacity L H	Confidence L_1 $_{10}H$ Confidence L H	Potential L_1 $_{10}H$ Potential L H	Total (Cols 4, 5, 6, 7)	Additional factors, opportunities/ threats	Rank

Table 3.8: Market audit industrial goods and services.

Customer(s) ______ Service/product ______				
Customer appeal	**Features**	**Advantages**	**Benefits**	**Proof**
What issues are of particular concern to the customer, e.g. cost, reliability, safety, simplicity, etc.?	What features of the product/service best illustrate these issues? How do they work?	What advantages do these features provide, i.e. what do they do for the customer?	How can tangible benefits be expressed to give maximum customer appeal, i.e. what does the customer get that he/she needs?	What evidence can be provided to back up the benefit and show it can be attained?
Example – *saucepans*				
Ease of use, ease of washing-up	Teflon-coated	This is a non-stick material	Trouble-free cooking, quicker washing-up	Results of tests
Example – *office services bureau*				
Accuracy and speedy turnaround of work	We use the latest equipment and very skilled staff	We are extremely versatile	Minimum of errors, cost-saving	What customers say

Table 3.9: Features, advantages, benefits (1).

Note:

1. To get from a feature to an advantage, and then to a benefit, the phrase 'which means that' can be helpful – for example, 'It's coated in new formula paint (feature), which means that the colour will never fade (advantage).' If you know this is what the customer needs, then you have also arrived at a benefit.
2. To check whether you have arrived at a benefit and not just an advantage, apply the 'so what?' test. Ask this question after the benefit. If the 'so what?' prompts you to go further, the chances are you have not yet reached the real benefit. For example, 'Our products are handmade (feature), which means they are better quality than machine-made ones (benefit?)' – so what? – 'which means they last longer (the real benefit)'.

Now try producing a benefit analysis for one of your own products or services, as it impacts on a specific customer or customer group. Use Table 3.10.

(*Continued*)

Customer(s) ______ Service/product ______				
Customer appeal	**Features**	**Advantages**	**Benefits**	**Proof**

Table 3.10: Features, advantages, benefits (2).

The customer audit applied to your own company

Working alone, and using your own company as the study vehicle:

1. Choose a major product or service, and identify:
   a) The main customers
   b) The features with maximum customer appeal
   c) The benefits to the customer of each feature
   d) Which of these benefits are differential benefits (i.e. benefits not recognized or stressed by your major competitors).
2. If you cannot identify any differential benefits, in what ways could you develop them?
3. For those you have identified, how could they be improved upon?
4. Identify your key market segments. How do you describe them?
5. If you cannot readily identify any distinct segments, what would be a sensible way to segment your markets?

Personal notes

Exercise 3.5 Micro-segments

Use the form provided to work out the micro-segments found in your market. For instructions on doing this, please refer to pages 133–136.

Micro-segment	1	2	3	4	5	6	7	8	9	10
Application (if applicable)										
What is bought										
Where,										
When,										
and How										
Who										
Why (benefits sought)										

A selection of standard approaches to profiling benefits

1. *Demographic characteristics*
   - Standard Industrial Classification (SIC) – the latest details are available from the appropriate statistical office. Summaries of both the UK/European and North American SIC systems appear below:

     United Kingdom and Europe
     Agriculture, Hunting and Forestry (01–02)
     Fishing (05)
     Mining and Quarrying (10–14)
     Manufacturing (15–37)
     Electricity, Gas and Water Supply (40–41)
     Construction (45)
     Wholesale and Retail Trade; Certain Repairs (50–52)
     Hotels and Restaurants (55)
     Transport, Storage and Communication (60–64)
     Financial Intermediation (65–67)
     Real Estate, Renting and Other Business Activities (70–74)
     Public Administration and Defence; Compulsory Social Security (75)
     Education (80)
     Health and Social Work (85)
     Other Community, Social and Personal Service Activities (90–93)
     Private Households with Employed Persons and Miscellaneous (95–97)
     Extra-territorial Organizations and Bodies (99)
     North America (USA, Canada and Mexico)
     Agriculture, Forestry, Fishing and Hunting (11)
     Mining (21)
     Utilities (22)
     Construction (23)
     Manufacturing (31–33)
     Wholesale Trade (42)

(*Continued*)

Retail Trade (44–45)
Transportation and Warehousing (48–49)
Information (51)
Finance and Insurance (52)
Real Estate and Retail and Leasing (53)
Professional, Scientific and Technical Services (54)
Management of Companies and Enterprises (55)
Administrative and Support and Waste Management and Remediation Services (56)
Education Services (61)
Health Care and Social Assistance (62)
Arts, Entertainment and Recreation (71)
Accommodation and Food Services (72)
Other Services (except Public Administration) (81)
Public Administration (92)

- Size of company – Very small, Small, Small–Medium, Medium, Medium–Large, Large, Very large, Very large+
- Department/Section – Manufacturing, Distribution, Customer Service, Sales, Marketing, Commercial, Financial, Bought Ledger, Sales Ledger, Personnel Estates, Office Services, Planning Contracts, IT
- Multidemographic – combining a selection of demographic criteria, such as size of company with job title, along with whether the company is public or private.

2. *Geographic*
   - Postcode
   - City, town, village, rural
   - Country
   - Region – frequently defined in the UK by TV region
   - Country
   - Economic/political union or association (e.g. ASEAN)
   - Continent.
3. *Psychographics – buyer characteristics*
   - Personality – stage in its business lifecycle (start-up, growth, maturity, decline, turnaround); style/age of staff (formal, authoritarian, bureaucratic, disorganized, positive, indifferent, negative, cautious, conservative, old-fashioned, youthful)
   - Attitude – risk takers or risk avoiders; innovative or cautious, and many of the adjectives used to describe different types of personality can also express a company's attitude towards your product line (as opposed to their distinctive personal character)
   - Lifestyle – environmentally concerned; involved with the community; sponsor of sports/arts.

A selection of standard approaches to profiling individuals

1. *Demographic characteristics*
   - Age – <3, 3–5, 6–11, 12–19, 20–34, 35–49, 50–64, 65+
   - Sex – male, female

- Family lifecycle – bachelor (young, single), split into dependants (living at home or full-time student) and those with their own household; newly married (no children); full nest (graded according to the number and age of children); single parent; empty nesters (children left home or a childless couple); elderly single
- Family size – 1–2, 3–4, 5+
- Type of residence – flat/house, terraced/semi-detached/detached, private/rented/council, number of rooms/bedrooms
- Income (£k) – <10, 10–15, 16–20, 21–30, 31–50, >50
- Occupation – operatives; craftsmen, foremen; managers, officials, proprietors; professional, technical; clerical, sales; farmers; retired, students; housewife; unemployed. white-collar (professional, managerial, supervisory, clerical); blue-collar (manual)
- Education (highest level) – secondary, no qualifications; GCSE; graduate; postgraduate
- Religion – Christian, Jewish, Muslim, Buddhist, Other
- Ethnic origin – African, Asian, Caribbean, UK, Irish, Other European
- Nationality
- Socio-economic – the eight-class version of the socio-economic classification (SEC) introduced by the Office for National Statistics (UK) 2001 and the former Registrar General's 'Social Class' can be found on pages 140 to 142.
- Multidemographic – combining a selection of demographic criteria, such as lifecycle stages and occupation groupings, on the basis that these are indicative of different aspirations and behaviour patterns.

2. *Geographic*
   - Postcode
   - City, town, village, rural
   - Coastal, inland
   - County
   - Region (frequently defined in the UK by TV areas – Anglia, Border, Carlton London, Carlton Central, Carlton West Country, Channel, Grampian, Granada, HTV, LWT, Meridian, Scottish, Tyne Tees, UTV, Yorkshire)
   - Country
   - Economic/Political union or association (e.g. NAFTA)
   - Continent
   - Population density
   - Climate.
3. *Geodemographics*. A Classification of Residential Neighbourhoods (ACORN) produced by CACI Ltd* is one of the longer established geodemographic classifications in the UK, updated with Census information and lifestyle data. ACORN covers every street in Great Britain and classifies the whole population into 56 types, summarized into 17 groups, which in turn are condensed into five broad categories. These five broad categories act as a simplified reference to the overall household classification structure and are as follows:
   1. 'Affluent Achievers'
   2. 'Urban Prosperity'

(*Continued*)

3. 'Comfortably Off'
4. 'Modest Means'
5. 'Hard Pressed'.

Geodemographic data are also combined with financial data to provide detailed information on financial product ownership. For example, Financial ACORN combines Census and financial research data into 51 types, 12 groups and four categories.

4. *Psychographic characteristics*
   - Personality – compulsive, extrovert, gregarious, adventurous, formal, authoritarian, ambitious, enthusiastic, positive, indifferent, negative, hostile; specific ones by sex have also been developed.
   - Attitude – degree of loyalty (none, total, moderate), risk takers or risk avoiders, likelihood of purchasing a new product (innovator, early adopter, early majority, late majority, laggard); and many of the adjectives used to describe different types of personality can also express an individual's attitude towards your product line (as opposed to their distinctive personal character).
   - Customer status – purchase stage (aware, interested, desirous, ready for sale), user classification (non-user, lapsed user, first time, potential).
   - Lifestyle – consists of three main dimensions:

Activities	Work, hobbies, social events, vacation, entertainment, club membership, community, shopping, sports
Interests	Family, home, job, community, recreation, fashion, food, media, achievements
Opinions	Selves, social issues, politics, business, economics, education, products, future, culture

     Because the data are based on individuals, variations in the attributes to be used can result in different people in the same household being selected.
   - Multidimensional – combining psychographic profiles with selected demographic data and identifying geographic areas where the resulting 'behavioural' types are found. For example, Experian's MOSAIC* classifies all the households and neighbourhoods (postcodes) in Great Britain into 52 distinct types which describe their socio-economic and socio-cultural behaviour. These 52 types are aggregated into 12 broad groups:

A	High Income Families	E	Council Flats	I	Independent Elders
B	Suburban Semis	F	Victorian Low Status	J	Mortgaged Families
C	Blue Collar Owners	G	Town House and Flats	K	Country Dwellers
D	Low Rise Council	H	Stylish Singles	L	Institutional Areas

* 'Experían' and 'MOSAIC' are trademarks of Experían Ltd. Further details can be found at www.micromarketing- online.com and www.experian.co.uk.

In addition to MOSAIC for Great Britain as a whole, there are separate MOSAICs for Scotland, Northern Ireland and London which identify differences only found in those areas. Experian has also extended MOSAIC to areas outside Great Britain.

Exercise 3.6 Simulation practice

In your game:

a) Are you serving consumers, customers or both?
b) What is the market definition? [Hint: Review the front page of the Marketing Plan]. Can it be redefined to be more needs-based?
c) How is the market segmented and how many segments are there? [Hint: Review the Performance Map].
d) How big is each of the segments and how fast are they growing? [Hint: Click on any of the segments to find out].
e) What percentage of your total sales and profits come from what percentage of segments? What other Pareto effects can you see in the game? How can this help you decide where to compete?
f) How will the market segments change in the future? [Hint: review all the information in the game to find out].
g) Is your current strategy excellent or weak? How can you improve it to beat the competition?
h) Where does the market sit on the diffusion of innovation curve? Are there any market segments that sit in a different position?
i) What are the key (decisive) buying factors of your customers? [Hint: Review the 'Value Proposition' chart in the Selected Segment tab to find out].
j) Considering your company, yourself and your team, what would you see as your CSFs? How can you exploit these to win the game?
k) What would a market map look like for the market in the game? Go back up the supply chain and do some further research outside the game if necessary.

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