



market equity

unlocking the value potential of your business

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An introduction to Market Segmentation

by **Malcolm McDonald**

Emeritus Professor

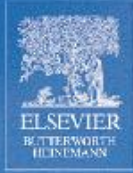
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UNIVERSITY

School of Management

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market equity

The essential segmentation text



Malcolm McDonald and Ian Dunbar

MARKET segmentation

HOW TO DO IT,
HOW TO PROFIT FROM IT

Market Segmentation: How to do it, how to profit from it is the only book that spells out a totally dispassionate, systematic process for arriving at genuine, needs-based segments that can enable organizations to escape from the dreary, miserable, downward pricing spiral which results from getting market segmentation wrong.

Nothing in business works unless markets are correctly defined, mapped, quantified and segmented. Why else have hundreds of billions of dollars been wasted on excellent initiatives such as TQM, BPR, Balanced Scorecards, Six Sigma, Knowledge Management, Innovation, Relationship Marketing and, latterly, CRM? The answer, of course, is because of a lack of a structured approach to market segmentation.

Market Segmentation: How to do it, how to profit from it provides a structured, no-nonsense approach to getting market segmentation right. It is an essential text for professionals and students based on a wealth of practical experience and packed with examples and easily used checklists.

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An introduction to Market Segmentation

by **Malcolm McDonald**

Welcome to my *Introduction to Market Segmentation*, one of the most fundamental concepts in marketing and critical to understanding how to create value.

Let us start by looking at how new products and services are diffused across markets over time as this will explain the factors that cause markets to break into smaller groups . . .

When something new is invented not everyone adopts one at the same time but clearly someone has to be first . . .

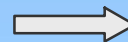
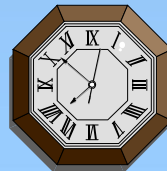
Diffusion of innovation curve *

Normally, about 2.5% of any population will be the first to adopt new products or services. These people are known as Innovators . . . they are very unusual people who enjoy being different.



2.5%

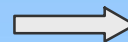
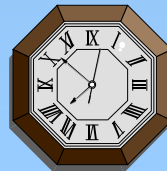
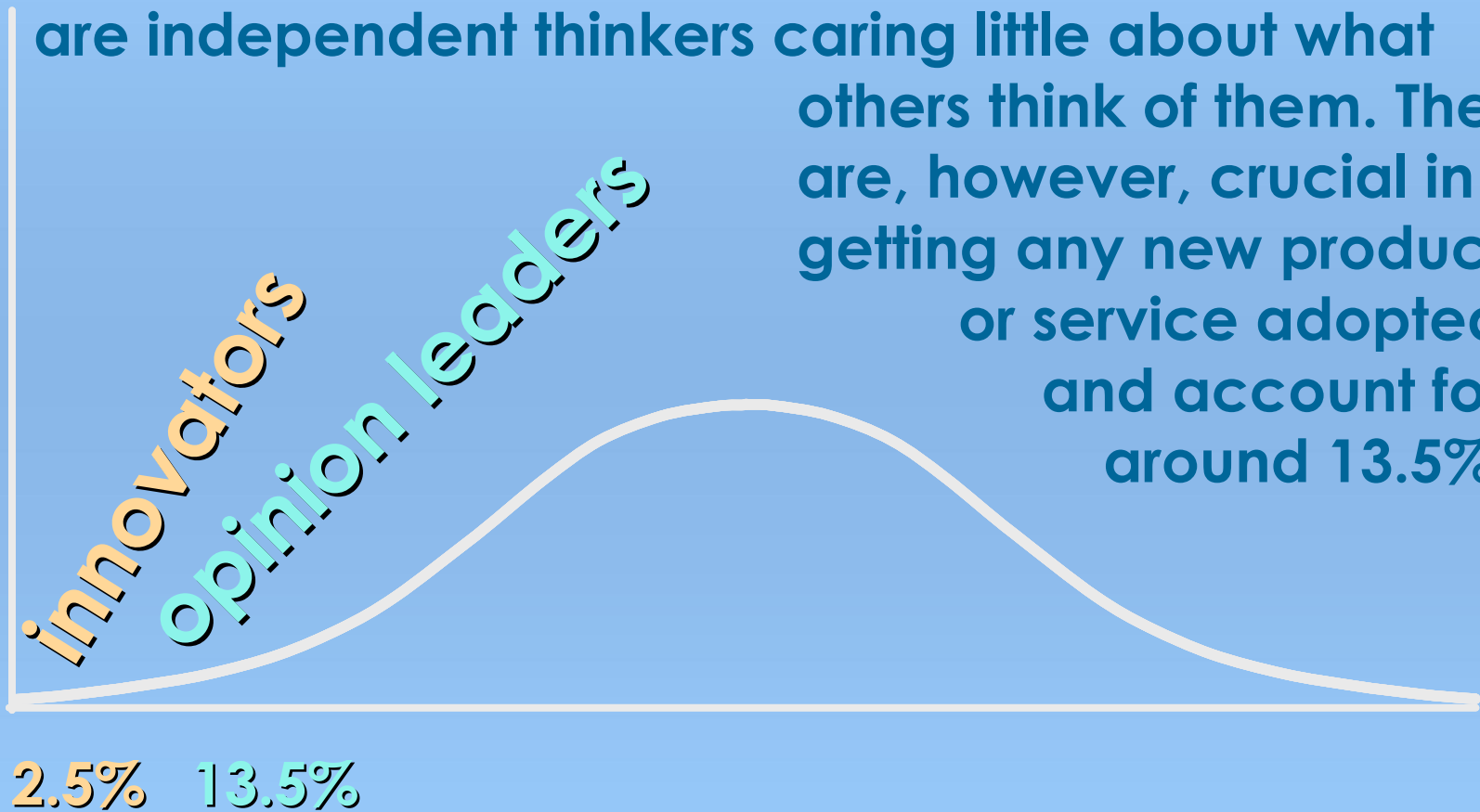
time



* Rogers, E. M. (1962).
Diffusion of Innovation.
New York: Free Press

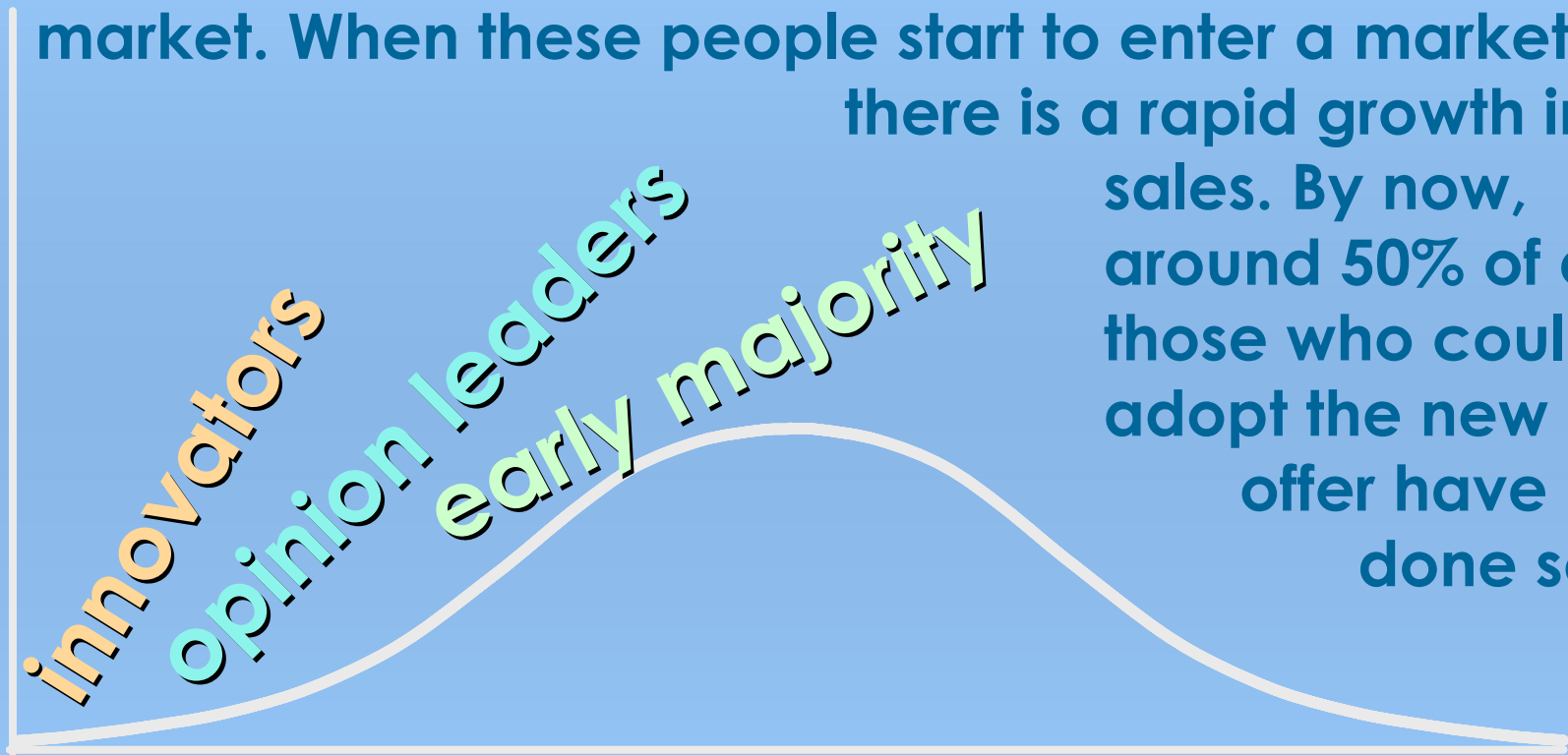
Diffusion of innovation curve

Innovators are followed by Opinion Leaders, often the more affluent and privileged in a market. They are independent thinkers caring little about what others think of them. They are, however, crucial in getting any new product or service adopted and account for around 13.5%.



Diffusion of innovation curve

Now that the new offer has been endorsed, a much larger group, the Early Majority (34%), enter the market. When these people start to enter a market there is a rapid growth in sales. By now, around 50% of all those who could adopt the new offer have done so.

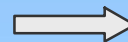
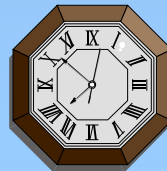


2.5%

13.5%

34.0%

time



Diffusion of innovation curve

At this point the Late Majority begin to enter the market. Generally, these people are less affluent and less privileged than those already in the market and price often becomes important at this stage.



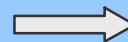
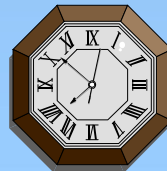
2.5%

13.5%

34.0%

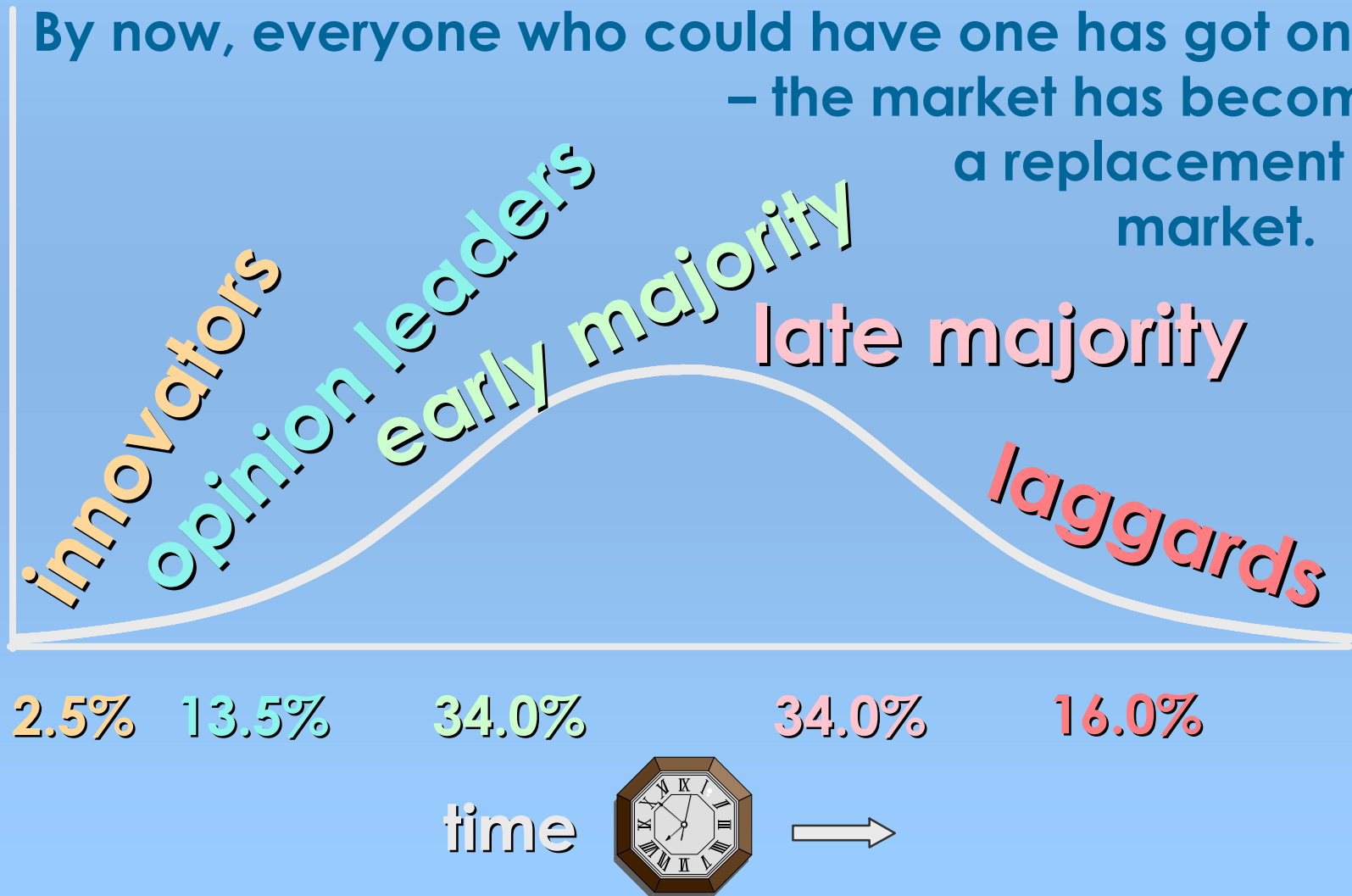
34.0%

time



Diffusion of innovation curve

Finally, the remaining 16% of the population adopt the new offer. Rogers referred to these as Laggards. By now, everyone who could have one has got one – the market has become a replacement market.

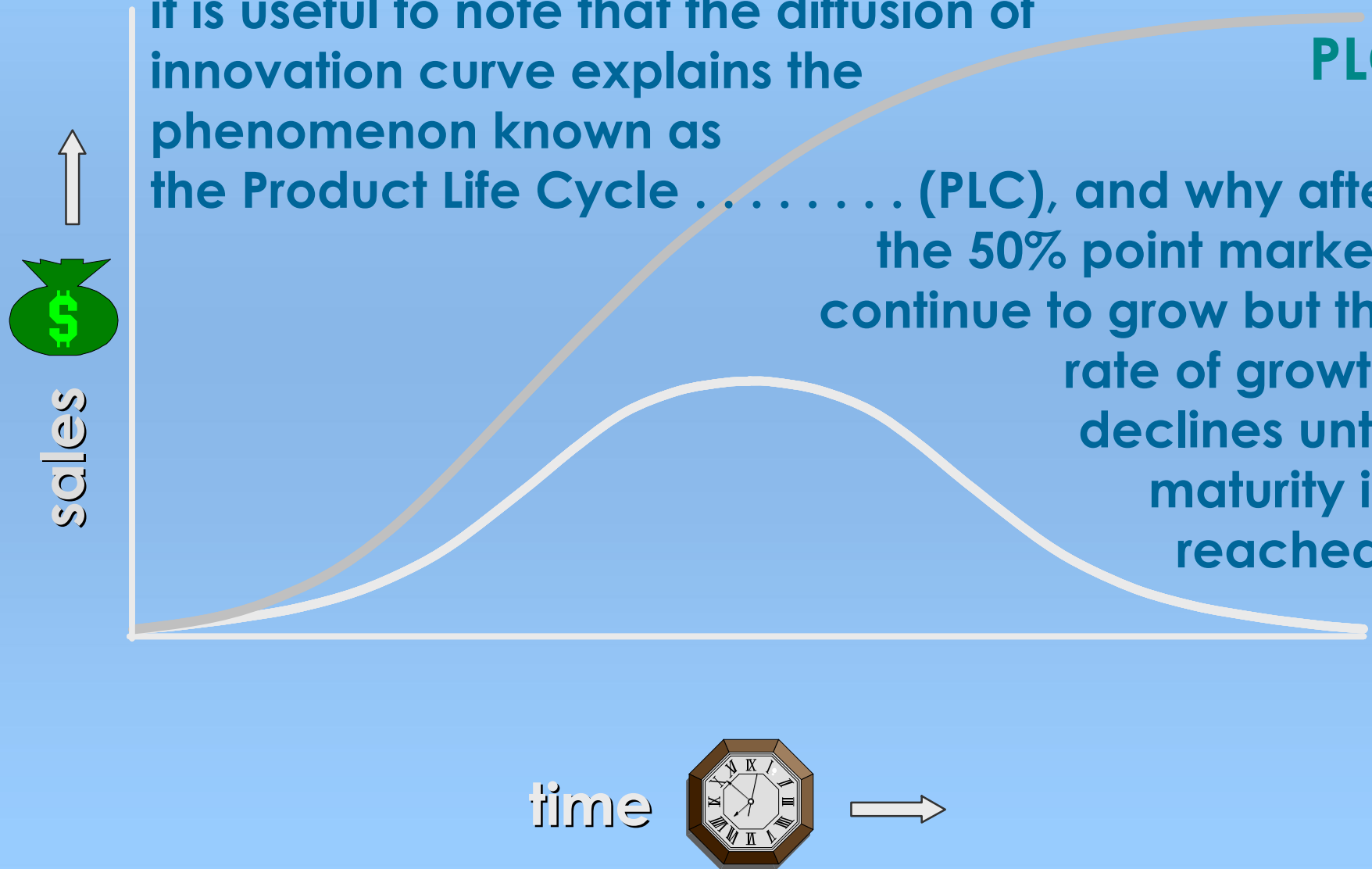


Product Life Cycle

Although this is not the purpose of this presentation, it is useful to note that the diffusion of innovation curve explains the phenomenon known as the Product Life Cycle (PLC), and why after the 50% point markets

continue to grow but the rate of growth declines until maturity is reached.

PLC



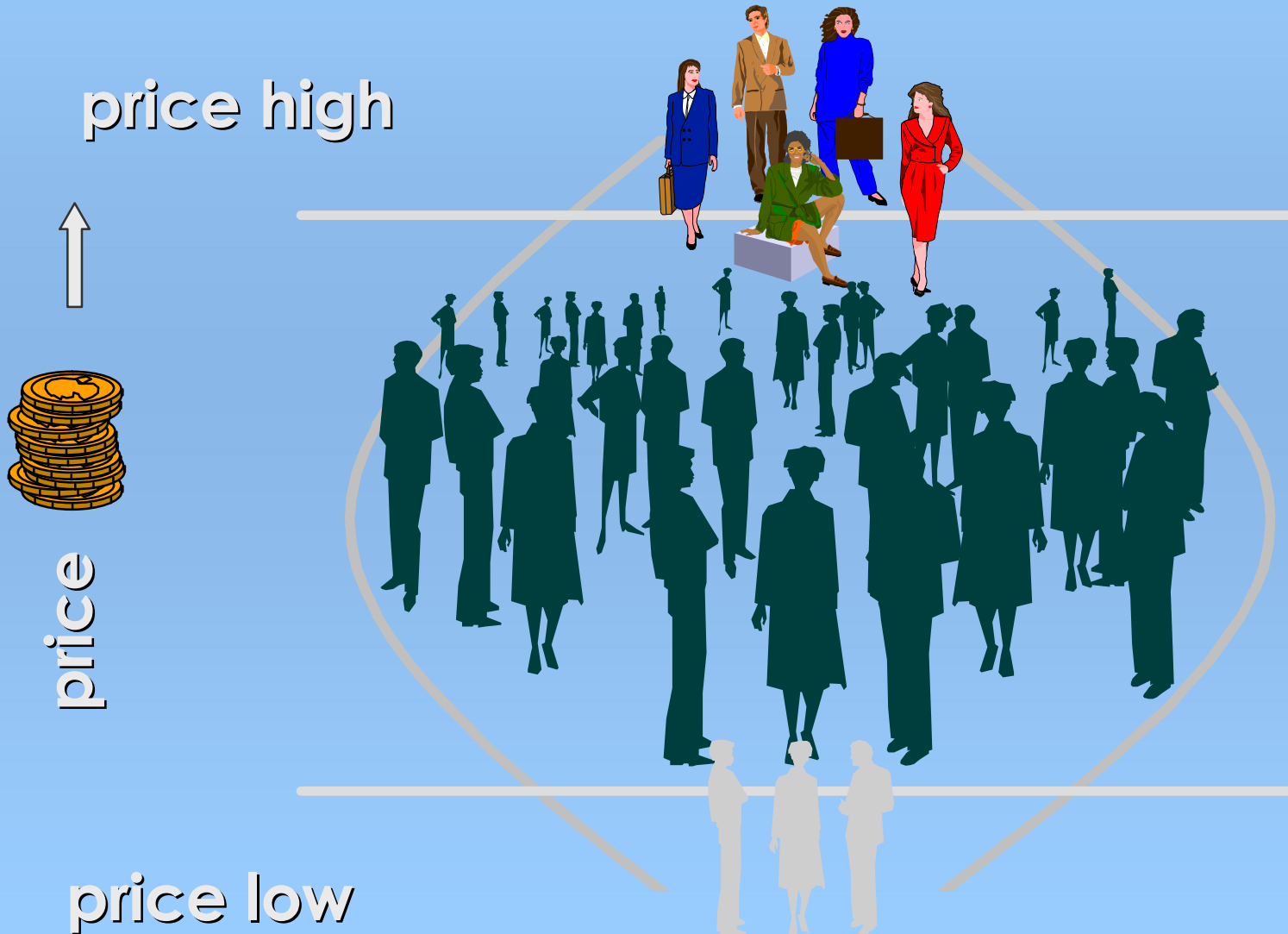
The emergence of segments

We can now see why, over time, variations on the basic offer will be required – the needs of this broadening base of customers will differ . . . they will divide into segments.

Mature markets and price

The picture we have developed also sees mature markets consisting of customers at one extreme largely insensitive to price and customers at the other extreme very sensitive to price. In the middle there will be a large number of customers, let us call them Mr and Mrs Average, for whom competitors will all too readily assume that price is their main requirement . . .

Distribution of customers in a mature market



Avoiding the commodity trap

Price is rarely the main requirement of customers. Only a lack of understanding by suppliers of the real needs of customers forces them to trade on price . . . avoiding this commodity trap is the whole point of Market Segmentation.

But astute marketers don't wait for a market to mature before adopting a segmented approach to their marketing mix, they avoid the commodity trap by understanding the real needs of customers at an earlier stage and by developing their offers accordingly, offers which deliver value to their customers and create value for their companies.

(Note: It is unusual for more than 10% of the customers in any market to be totally driven by price.)

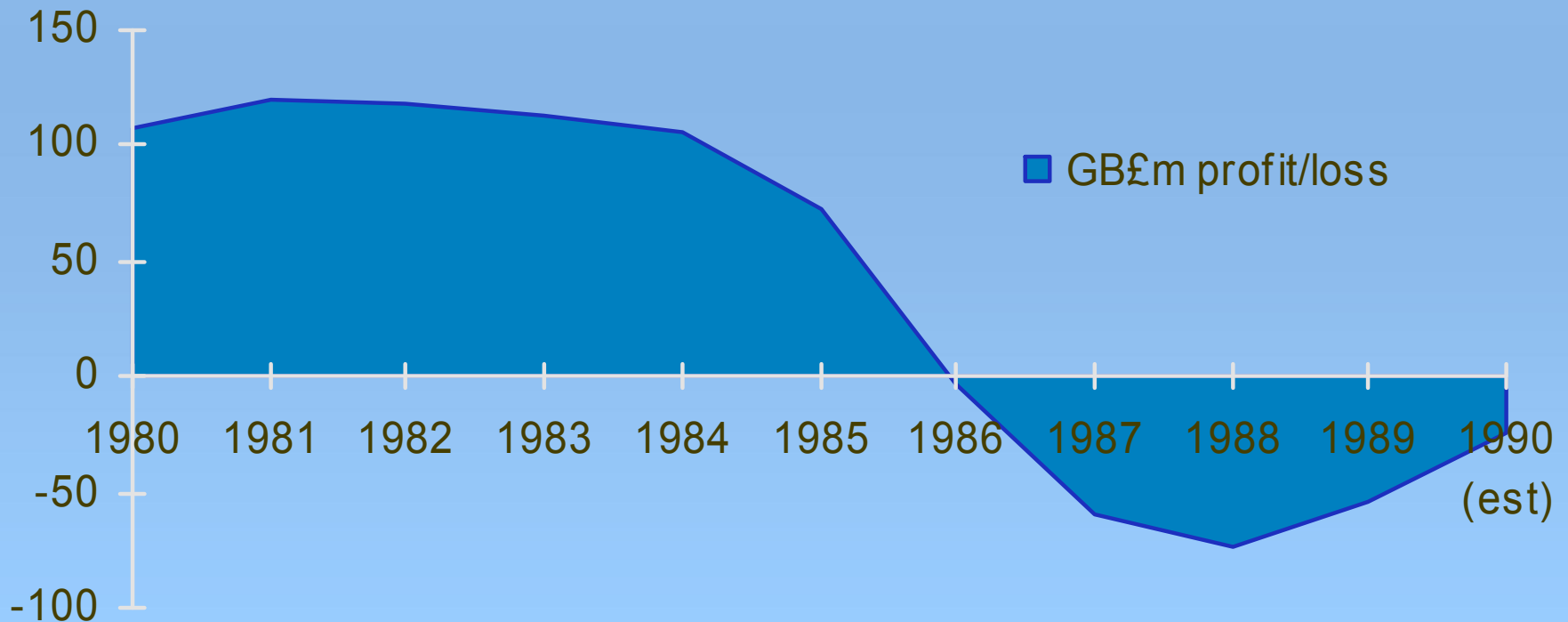
Segmentation case history

The following is an example of how one UK company, ICI Fertilizers (ICIF), during a time when the whole European fertiliser industry had fallen into a commodity trap where all suppliers talked only about 'price', discovered through Market Segmentation that the market was far from homogeneous and divided into seven very distinct groups of customers, each with different needs.

By adopting a segmented approach to its marketing activity while its competitors continued to slither down the pricing spiral to ever increasing losses, this company became the most profitable in its sector.

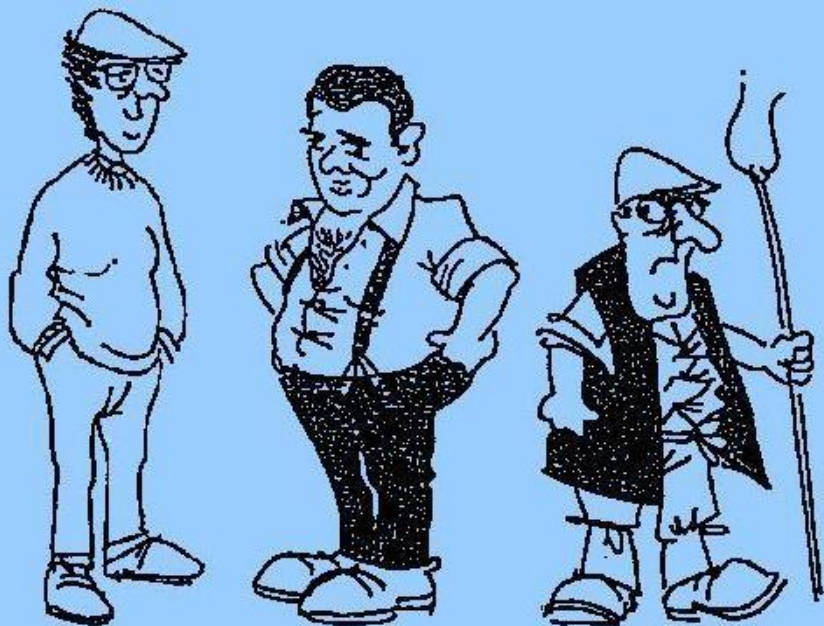
Segmentation case history

To accompany a decline in market share, caused by competitors being attracted into the market by previous high growth and profits, the most telling picture of ICIF's predicament was its decline in profitability – partially recovered by huge cut backs but not enough to achieve profitability.



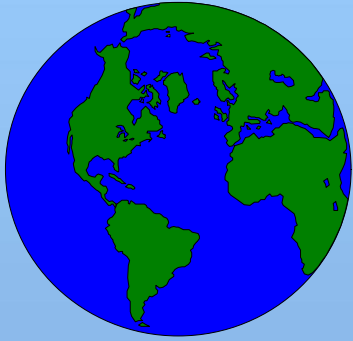
Segmentation case history

The company's segmentation project, which was based around understanding the real needs of the customers in their market, found that only one of the seven segments focussed on price (representing just 7% of the total). Each of the other six segments, three of which appear to the left, offered much more profitable opportunities, if only a supplier would sit up and take notice!



So ICIF did just that and began to match specific propositions to segments. New products, new promotional approaches, new prices, and PROFIT.

Key elements of world class marketing



According to the 'gurus' of marketing it's . . .



1. A deep understanding of your market
2. Creative segmentation and selection
3. Powerful differentiation, positioning and branding

. . . and in that order.

This gives us a clue as to how we arrive at meaningful market segments . . .

The segmentation process

Stage 1 – Your market and how it works

Step 1 – Defining the 'market'
The scope of the project

Step 2 – Market mapping
Structure and decision-makers

Stage 2 – Decision-makers and transactions

Step 3 – Who specifies what
Decision-makers and their purchases

Stage 3 – Segmenting the market

Step 4 – Why
The needs of decision-makers

Step 5 – Forming segments
Combining like-minded decision-makers

Stages 1 to 3 – Developing segments

The segmentation process

Stage 1 – Your market and how it works

Step 1 – Defining the ‘market’ The scope of the project

It will be obvious that very few of the tools and techniques of marketing, including segmentation, have any meaning unless there is a correct definition of ‘market’.

This is essential for:

1. measuring ‘market’ share and ‘market’ growth;
2. the specification of target customers;
3. recognition of relevant competitors; and, most important of all,
4. the formulation of marketing strategy, for it is this, above everything else that delivers differential advantage and sustainable improvements in value.

The segmentation process

Stage 1 – Your market and how it works

Step 1 – Defining the 'market' The scope of the project

And a 'market' is best defined in terms of a customer need which covers the 'aggregation of all the products and services which customers regard as capable of satisfying the same need'.

In addition, a segmentation project clearly requires a geographic boundary, within which the stage of market development, the available routes to market and the pattern of marketing activity are all the same, or similar.

The scope of the project must also take into account the capabilities of the company to ensure it is meaningful.

The segmentation process

Stage 1 – Your market and how it works

Step 1 – Defining the ‘market’

The scope of the project

Step 2 – Market mapping

Structure and decision-makers

Market mapping corresponds to ‘a deep understanding of your market’. Essentially this entails drawing the distribution and value added chain that exists between the final users and suppliers in the defined market, allocating volumes or values to the chain and identifying where decisions are made about competing products and services. It is the needs of these decision-makers we must understand.

In a sense, the market map is like a balance sheet with the number of units ‘consumed’ equating to that supplied.

The segmentation process

Stage 1 – Your market and how it works

Step 1 – Defining the 'market'

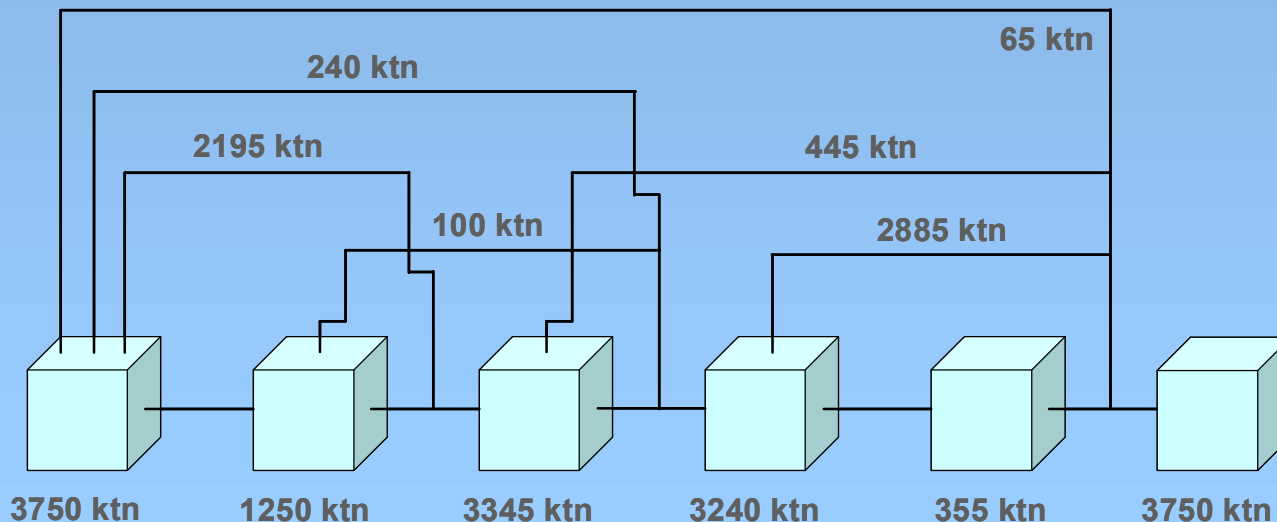
The scope of the project

Step 2 – Market mapping

Structure and decision-makers

Here is an example of a market map showing a distribution and value added chain with the volumes flowing along it.

Manufacturers Importers Distributors Consultants Specialist publications Farmers



Total UK Market – 3750 ktn
ICI Fertilizers' share – 30%

The segmentation process

Stage 1 – Your market and how it works

Step 1 – Defining the ‘market’

The scope of the project

Step 2 – Market mapping

Structure and decision-makers

Stage 2 – Decision-makers and transactions

Step 3 – Who specifies what

Decision-makers and their purchases

A representative sample of decision-makers in the market is developed (Micro-segments). They differ by the features they use to discriminate between alternative offers (Key Discriminating Features). Each is profiled with attributes that describe who they are and sized.

Note: The sample represents actual purchase behaviour in the market. ²³

The segmentation process

Stage 1 – Your market and how it works

Step 1 – Defining the 'market'

The scope of the project

Step 2 – Market mapping

Structure and decision-makers

Stage 2 – Decision-makers and transactions

Step 3 – Who specifies what

Decision-makers and their purchases

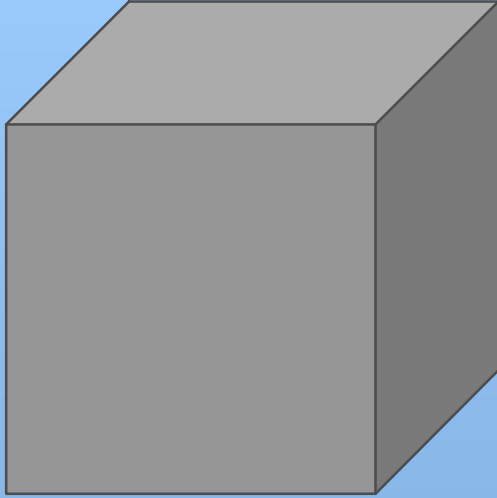
Stage 3 – Segmenting the market

Step 4 – Why

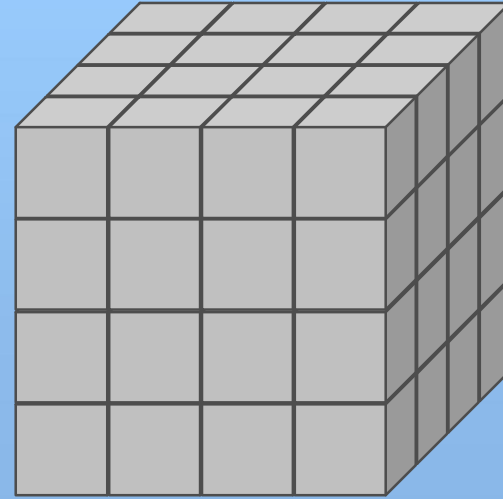
The needs of decision-makers

Step 4 uncovers the motivations that lie behind purchase behaviour by linking key features to their benefits (Decisive Buying Criteria). Market research may be required.

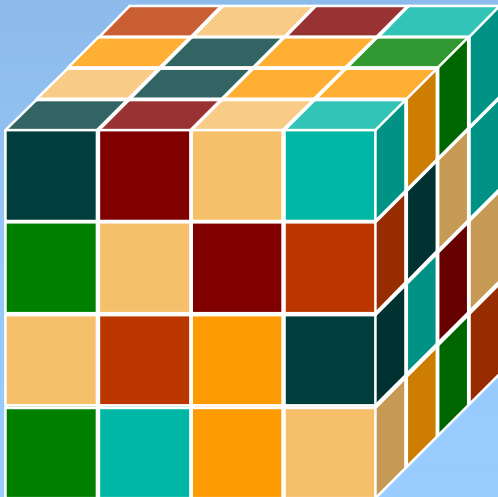
To summarise so far . . .



1. No market is totally homogeneous

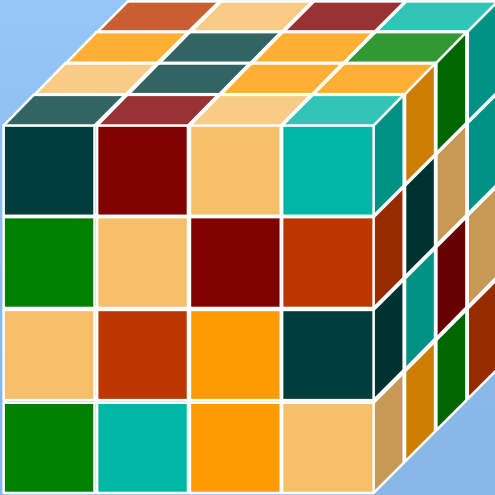


2. The reality is, markets consist of a variety of purchase behaviours



3. And by understanding the motivations behind this behaviour we identify the benefits being sought

The segmentation process



All we need to do now is bring like-minded decision-makers together to form a series of clusters



(Computer programs can assist you here)*

Stage 3 – Segmenting the market

Step 4 – Why

The needs of decision-makers

Step 5 – Forming segments

Combining like-minded decision-makers

*See *Collateral* on the market-equity.com website for more details.

The segmentation process

The profiling attributes linked to the micro-segments, along with their sizes, are then consolidated for each cluster and the segment reality check applied:

1. **Volume/value** – is each cluster big enough to make it worth developing a specific proposition for it and taking this into the market?
2. **Differentiation** – is the proposition required by each cluster sufficiently different from that required by other clusters?
3. **Reachability** – is each cluster reachable through distribution channels the company can use and for communication purposes?
4. **Compatibility** – is the company capable of adapting its structure, information and decision making systems to serve each cluster effectively?

Step 5 – Forming segments
Combining like-minded decision-makers

Market segmentation and corporate responsibility

It will now be clear that Market Segmentation is:

- Fundamental to corporate strategy and unlocking the value potential of your business
- Too important to be left to the marketing department – it affects the whole company
- Senior management must focus on market segmentation

... it's important and must be carried out thoroughly!

Segmentation review

- Not all customers have the same needs.
- A successful market segmentation project positions customer needs at the heart of its process:

1. Define the market to be segmented*
2. Determine how your market works and identify who makes the decisions
3. Develop a representative sample of decision-makers capturing differences in the features they see as key; describe who they are and size them
4. Understand their real needs
5. Search for groups with similar needs

- Once a market is segmented, select a segment and serve it. Do not straddle segments and sit between them.

Segmentation process summary

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.

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?

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.

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 which 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

Conclusion

Segmentation is the heart and soul of marketing and unless a company spends time on it, driven from the board downwards, it is virtually impossible for the company to identify and successfully implement the strategies which realize the value potential of its market.

I therefore hope that you have found my brief *Introduction to Market Segmentation* both interesting and encouraging. It has outlined an approach that produces spectacular results.

Take this as an opportunity to discuss your own project with us, we would be very pleased to hear from you.

And a final comment for those of you who are in companies already performing well; remember, you do not have to be sick to get better!

Best of luck.

Malcolm McDonald



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