MARKET SEGMENTATION

A GUIDE TO CONDUCTING SEGMENTATION RESEARCH

Market segmentation is a popular technique in marketing, marketing research and strategic planning. Market segmentation identifies unique groups of consumers in a market for various end-goals, including:

1. Better understanding of consumers
2. Tailoring of marketing communication messages
3. New product development/line extensions/re-branding
4. Identifying potential economic/ volumetric opportunities of the segments

The purpose of this document is to outline when it is appropriate to consider segmentation and the basic steps for executing segmentation research.

WHEN TO CONSIDER SEGMENTATION

The need for market segmentation can be shown by examining the category life cycle. In the early stages of a new product category, there are few brands and few buyers. Market segmentation at this stage is simply separating those likely to try the new product from those less likely. Media campaigns, advertising copy, and distribution channels are developed with this "likely to buy" group in mind. For example, when the VCR was first introduced, the marketing efforts were targeted at those people likely to try this new technology. A limited segmentation scheme such as this is justified because the first people to try a new product are rare, relatively homogeneous as early adopters/innovators, and do not require differentiated marketing campaigns.

Further segmentation would be costly and would require committing resources that could be more effectively used elsewhere. In this stage of the category life cycle further segmentation is not justified.

As a product category matures, however, new features are added to existing products, the product gains distribution, more people become aware of the product, and buyers become more savvy about the product and its benefits. Likewise, competition increases. At this point, the seller must focus on more than selling a "new" product. The seller must also identify and meet the differing needs of the market.

As needs or desires expand into various stages of heterogeneity, the seller is faced with continuing to consider all buyers as similar or adopt some type of market segmentation. The purpose of segmentation research, then, is to find those unique subsets of the market that can be identified and treated as a group. The goal is to identify groups such that buying behavior within a group is similar (segment homogeneity) and the behavior between groups is different.

If the buyers have homogeneous needs, a company is best served by not segmenting the market. This is the case with most new (or innovative) products and some commodity products. Virtually every market, however, can benefit from a segmentation approach.

BASIC STEPS FOR SEGMENTATION RESEARCH

In deciding how to identify segments, the researcher must answer four questions:

1. What is the key objective of the segmentation?
2. What method should be used to segment the market?
3. What variables, or basis, should be used to segment the market?
4. How many segments should be formed?

1. Objective

Frequently, the initial decision to conduct segmentation research is based on the desire to better understand consumers. Though this is a key starting point, it is important to subsequently detail the strategic objectives to be met by this better understanding. This is the time to consider how the segments will be used once they have been identified. Taking the time to do this at the start of the process is essential for successful segmentation research.

2. Method

The method of segmentation refers to when the segments are defined. There are two methods of segmentation.

They are a *priori* and *post hoc*.

Segmentation requires that respondents be grouped based on some set of variables that are identified before data collection. In a priori segmentation, not only are the variables identified, but so are the segment definitions. For example, consider a study in

	HH Income		
	< $25k	<$25k - $75k	> $75k
A 18-34			
G 35-54			
E 55+			

which respondents are to be grouped based on age and household income. An a priori segmentation scheme could use the following categories shown above.

In this scheme, each respondent could be placed in the proper category as soon as these two pieces of information were known.

Post hoc segmentation, on the other hand, requires only that the variables on which the segmentation will be based (but not the segment definitions) be identified. The segments are then determined by using an analytical technique (such as cluster analysis) after all the data is collected. For example, if post hoc segments were to be formed on psychographics, the psychographic scores for all respondents would be cluster analyzed. The segments would not be known until after running cluster analysis. This allows groups to be formed based on "natural" breaks in the data. This method is sometimes referred to as response-based.

The *post hoc* benefit segmentation approach has become the preferred choice in most large “baseline” segmentation studies. By knowing what benefits buyers in a specific segment are looking to receive from a product, the marketing mix is more clearly guided to appeal exactly to that target market.

3. Basis

After determining the Method of segmentation, the researcher must determine what characteristics to use to identify the segments. These characteristics are referred to as the basis of segmentation. Unlike the method question which had two possible answers, the basis question is limited only by the researcher's imagination.

Common Basis Variables

GEOGRAPHIC			
Region	Urban/Rural	City/Country/ Size	
DEMOGRAPHIC			
Age	Gender	Income	Education
Presence of Children	Occupation	Ethnicity	
ATTITUDINAL/PSYCHOGRAPHICS			
Lifestyles	Interest	Opinions	Values
PRODUCT USAGE OR KNOWLEDGE			
Frequency of use	Brand loyalty	Attitude toward product	
Level of product knowledge	Usage patterns	End use	
Involvement with category	Purchase volume		
DECISION PROCESS			
Decisions making unit	Shopping pattern	Media use	
Information search	Distribution channel	Buyer profile	
ADOPTION PROPENSITY			
Interest in new products	Opinion leadership	Likelihood of buying new products	
FIRMOGRAPHIC			
SIC/Industry	Buying centralization	Size *(employees/ revenue/worksites)*	
NEEDS/PRODUCT BENEFITS			
Needs to be filled	Expectations	Perception of product	
Satisfaction	Product preference		

The following table illustrates some of the most frequently used bases of segmentation.

Each of the major bases are discussed below:

Geographic

Geographic segmentation calls for dividing the market into geographic regions. This allows the company to operate in only a few regions, because of limited demand or resources, or the company can tailor some element of the marketing mix by region. Food products are frequently varied by region. Either some products are only offered in certain markets, or the differing products are sold in the same container with the same advertising and promotion in different geographies.

Demographic

Historically, the most common bases of segmentation have been demographic in nature – women between 18 and 49, for example. These schemes have frequently been motivated from a shopping or media behavior perspective and not one of brand or category choice behavior. While these schemes might adequately identify the frequent purchasers of a product category, they generally don't fit the definition of segmentation as outlined above – dividing consumers by product choice behavior. Income, education, ethnicity, and occupation are all frequently used demographic segmentation variables.

Attitudinal

Attitudinal variables are used based on the idea that opinions, traits, interests, and lifestyles influence buying behavior. Put another way, people with similar psychographic profiles should respond similarly to various marketing mixes. It is not clear that psychographics directly influence brand choice but are likely related to usage in several categories. Their application to market segmentation is well established.

Product Usage

Product usage variables are also used to segment markets based on category usage, product usage, or brand loyalty. It is a common practice to segment the market into users and non-users and also by level of use (heavy vs. light).

Decision Process

People decide which product to buy in different ways. The influence that people exercise over decisions, as well as their brand loyalty, variety seeking behavior, information search, distribution channel used and decision making units (centralized versus decentralized) all impact the brand that they will purchase. While this focus is more prevalent in business-to-business settings, certain elements are perfectly applicable to consumer segmentation as well.

Firmographic

The firmographic variables of SIC, revenue and number of employees are standard bases for industrial segmentation. Firmographic segmentation is based on the idea that companies can be targeted based simply on what industry they are in or how large they are. This approach has been criticized as largely ineffective.

Adoption Propensity

As shown when introducing the idea of segmentation, new product introductions can likely be made more efficient by targeting the early adopters of a product category. Segmentation based on adoption propensity might be based on the propensity for the specific product or category, or it might be based on a buyer's characteristic or propensity to adopt new product across several categories. This approach might even involve opinion leadership – people whose opinions are sought even though they might not be early adopters.

Needs-Based or Benefit Segmentation

Needs-based or benefit segmentation is substantially different from the methods mentioned above. Instead of relying on descriptive factors (like region, age, income, brand loyalty, or product usage), segments are derived based on causal factors relating to the purchase process. People buy products, and decide between different brands, because of the perceived unique benefits that one product can provide over another, and the relative importance of those benefits. Benefit segmentation partitions the market into segments based on benefits sought. The result is that the people in one segment are seeking to realize some rather homogeneous set of benefits with a particular product.

Those familiar with conjoint analysis can readily see the applicability for conjoint to measure the relative importances of the benefits sought.

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4. Number of Segments

Another question that must be answered in any segmentation study is how many segments to use. The decision on how many segments has considerations from both statistical and managerial viewpoints. Segments can almost always be made more homogeneous by increasing the number of segments. This could continue until the number of segments becomes unmanageable. One practical guideline is that unless the market can be broken into at least three groups, the advantages of segmenting are not cost effective over a general market approach; and attempting to market to more than seven segments is not practical for most companies.

There are obviously many possible ways to segment a market. There is no single right answer and each situation can produce a different recommended "best" solution. What should be obvious is that although segmentation research involves substantial scientific processes, it also relies inescapably on managerial judgment and the *art* of segmentation.

HOW TO USE MARKET SEGMENTS?

To be most useful, the market segments just identified should be tracked in all future research. To do this, researchers must develop a way to make the segments identifiable and meaningful so that they can be incorporated in future efforts. This happens through segment profiles or descriptions. Segment descriptions are useful for two primary reasons.

1. Most large segmentation studies use variables that are not easily observable as the basis of segmentation. Measurements like large psychographic batteries, part-worth utilities from conjoint and product preferences are frequently used basis variables. Instead, the segment profiles can be used to identify the segments.

2. Profiling the segments can provide a validity check for the segmentation results themselves. The profiling stage can assist in the identification of meaningless or artificial segments. If the profiles don't make sense from a managerial perspective, the segmentation scheme must be reconsidered.

Typical profiling variables are demographics, psychographics, or other descriptive variables. There are a number of proven research techniques that assist in profiling the segments. The methods range from simple cross-tabs to complex multivariate analysis procedures. Examples include multiple discriminant analysis, logistic regression, correspondence analysis, and CHAID.

WHICH SEGMENTS DO WE TARGET?

Once segments are identified and profiled, there is one more inescapable question: Do we target all of these segments or are our products suited for just a subset of the segments? The answer to this question has many considerations: available resources, current company image and its portability, competitive positioning, and market/industry dynamics. The basic approach, especially in benefit segmentation, is to evaluate each segment's desired product and evaluate whether current or new products can meet that segment's needs without deteriorating current franchise positioning. For example, many niche products which can command a price premium in their niche would require price parity or even discounts when outside of their niche. In this case, appealing to segments beyond the current niche is likely unprofitable. This consideration of targeting must go beyond just the market's desired product specifications, but must also include their willingness to consider a particular brand and distribution channels.

WHAT DOES SEGMENTATION REQUIRE?

Effective segmentation requires that truly different groups be identified. They must be:

- Large enough to be economically sustainable (size)
- Different enough to justify the increased cost of segmentation (different)
- Similar enough within each segment to be treated as one group (homogeneous)
- Identifiable through segment profiling (actionable)
- Accessible through unique media/distribution (accessible)
- Stable enough to exist over some planning horizon (stable)

Each of these six requirements must be met to justify a segmentation approach. These requirements are each discussed in turn.

Size

The segments must be large enough to sustain the additional cost incurred by segmentation (like developing specialized communication messages). Segment size is a relative question based on the size of the company, the size of the market, and the buying power of each customer. Boeing, for example, would be able to define each potential customer as a separate segment and tailor their marketing mix to each buyer's individual needs. A manufacturer of breakfast cereal, however, must segment the market on a more general basis.

Different

The individual segments must be different from each other. If all buyers in the market behave basically the same, there is no need to segment the market. Likewise, if segments are found in which the behaviors across groups are basically indistinguishable, the segmentation scheme is not accomplishing what it should be. Markets for non-differentiated, or commodity products would not benefit from a segmented approach. A manufacturer of commodity products can more efficiently reach the entire market with one marketing strategy than with several. There are, however, few markets that are absolutely not segmentable. That is, almost every market has identifiable groups that behave differently and by focusing on these differences, companies can increase their marketing effectiveness.

Homogeneous

Just as the segments need to be different, those potential buyers in the same segment need to be similar. That is, they must behave similarly. This is necessary to treat the segment as one entity.

Actionable

Segments must be profiled so that potential buyers can be placed in a segment, based on easily measurable variables. This allows the researcher to use the segmentation scheme in future research without having to recreate the segmentation scheme. These profiles could, for a priori segmentation schemes, be the basis variables themselves. If segments were based on age and number of children, or geographic region, for instance, there would be little trouble assigning individuals to the proper segment. If however, a more sophisticated scheme is used to identify segments, the researcher must be able to assign observations to segments independent of the basis variables. Segments from post hoc assignment are formed on basis variables that are difficult to measure--like attitudes or attribute importances. If the segments from a *post hoc* segmentation scheme cannot be profiled, the segments will be difficult to carry forward into future studies.

Accessible

The segments must also be reachable. To the extent that a segment exists, but cannot be educated about a product's potential benefits by advertising, point of purchase, or another method, it is of very little use to the company and of no more value than the unsegmented market.

Stable

Stability over time is also a reasonable concern for segmentation studies. The question is not so much that one person stays in the same segment all the time, but that over time, the same basic segments exist, in about the same size, with the same basic profiles.

WHAT MAKES SEGMENTATION RESEARCH SUCCESSFUL?

As pointed out above, almost any marketing effort can be made more effective with market segmentation, and almost any marketing research can be made more informative by analyzing the results at the segment level.

While most people can clearly see the benefits of segmentation, many are hesitant to commit the time and effort necessary to perform a good segmentation study. Many people are tempted to perform a rudimentary segmentation study hoping that the outcome will be as if the research design had been fully, and carefully, developed. This fear has prompted some to refer to the "generic segmentation study, one done mindlessly and mechanically, following specific steps by rote under the assumption that clear-cut and insightful segments will somehow magically pop out of the welter of statistical output generated."[1]

The keys to successful segmentation research are:

1. Clearly defined goals and objectives
2. A substantial amount of up-front work
3. A thorough examination of segmentation dimensions
4. Well developed plans for follow-through activities (use what you have learned)

Market segmentation is an extremely powerful strategic marketing tool. It must be treated as a strategic tool, though, and involve all levels of management and all future marketing decisions. When well considered, well planned and well executed, segmentation research can provide insights into your market that would otherwise go unnoticed and can provide increased efficiencies in all marketing efforts: product design, communication, distribution, and pricing.

[1]Haley, Russell. (1984), "Benefit Segmentation: Backwards and Forwards," Journal of Advertising Research, 24 (February/March), 19-25.