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Winning at Segmentation

Strategies for a Digital Age

Abstract

Segmentation has long been considered a basic exercise to understand customers, competitors and the operating environment to enable businesses to make the most of market opportunities and minimize threats or business risks. Over the years segmentation approaches have evolved and broadened using a variety of metrics including simple demographics, behavioral, psychographic, needs-based, and profitability-based or a combination of these. However, these approaches have certain limitations that impede their efficacy. Moreover, the present context of changing consumer behavior, heightened brand competition and growing influence of the digital medium is forcing organizations to rethink their approach towards segmentation. Organizations are looking for models that can help them overcome the challenging task of discerning consumer buying behavior in relation to organizational capabilities and competitive standing.

We believe that organizations need to take a fresh look at their approach towards segmentation. This approach is contingent on a 'Value From' and 'Value To' criteria that flows from design to action across various stages of the segmentation approach. Organizations should assess their current state comprehensively and then design a multi-dimensional segmentation framework. They should then develop a clear value proposition, define and deliver their capabilities and finally ensure continuous measurement. Segmentation should be spread across the organization; understanding the customer should be a way of life and a fundamental driver of shareholder value.

The Changing State of Segmentation

Segmentation is widely acknowledged as a fundamental component of understanding and addressing an organization's market. Most companies employ some form of market segmentation, even if rudimentary, to inform key strategic and investment decisions. Today, customer segmentation is no longer a simple, or static, marketing technique; it is core to the way successful companies run their businesses. However, despite the wide-spread use of segmentation and the importance of getting segmentation right, seldom do segmentation schemes live up to the expectations of the management. Considering the significant investments of time, effort and money to construct robust segmentation models, overcoming some of the common mistakes to segmentation and achieving more actionable solutions has become a strategic imperative.

In the scenario of widespread changes to the consumer and technology landscapes, it has become imperative for companies to rethink their traditional approaches to segmentation. Most organizations continue to adopt segmentation classifications that squarely focus the products and services at 'Phantom Targets' – internally defined segmentation classification that does not relate to how customers actually buy. Not surprisingly, this is a cause of many failed product and service efforts.

Through this paper we argue that as customer centricity becomes an increasing source of competitive advantage it will become critical for companies to adopt a more 'outside-in' approach to segmentation. This means segmenting the customer not only on things that are of value to the organization but also on things that are of value to the customer. Based on this notion of shared value, lead practices in customer segmentation are starting to emerge.

Defining Segmentation and its Need

Segmentation is a way of organizing individuals into groups with similar traits, performance characteristics or expectations, which can be obvious and simple at one extreme or complex at the other. Information requirements and the organizing tools used to create the segments vary greatly as the nature and purpose of segmentation changes. Organizing customers around homogeneity of needs requires a thorough understanding of customer requirements. This understanding results in both authentic customer understanding and the determination of optimal customer segments.

An organization should be able to categorize customers into groups with similar requirements/characteristics, if an effective response capability to these characteristics is to be developed. Moreover, it is also important to understand that as a performance area becomes more complex and expectations diversify, there is an ever-increasing need for greater insight. As the need for insight increases the ability to group performers according to that insight becomes essential.

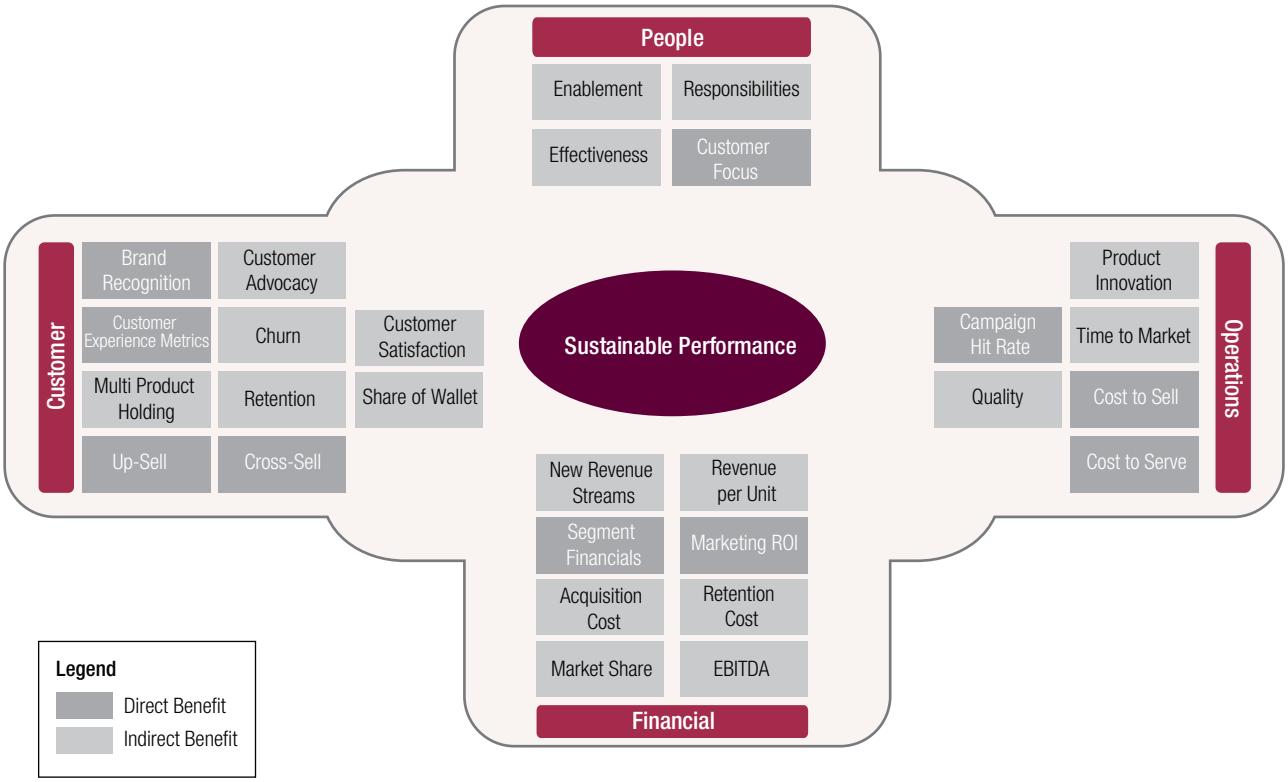
Benefits of Segmentation

The value that an organization derives from segmentation varies according to the context. For instance, segmentation provides marketing with the information to identify, attract, develop and retain the most valuable customers. It can also identify customers that are most vulnerable to, and most winnable from, competition. In the current business context of dynamic customer behavior and impact of digital tools and techniques on the buying process, a well-defined segmentation process would enable the development of offerings that are more differentiated and less commoditized, shifting the basis of competition from price to value. For instance, BMO financial group from Canada aligned its customer service teams to its three value-based segments supported by upgraded technology. This alignment supported a differentiated customer experience, enabled high level of employee engagement and recorded multi-million dollar benefits over a 3-5 year period[1].

A well-defined segmentation process helps develop offerings that are more differentiated and less commoditized, shifting the basis of comparison from price to value

Benefits from segmentation can broadly be categorized into direct and indirect benefits along the business elements of customer, people, operations, and finance (see Figure 1). Indicative direct benefits from segmentation include enhanced marketing return on investment and campaign hit rate. Potential indirect benefits include employee enablement, reduced customer acquisition cost and product innovation.

Figure 1: Benefits of Segmentation



Source: Capgemini Consulting analysis

Limitations with Traditional Approaches

Despite its wide ranging benefits, traditional forms of segmentation often fall short of producing the intended effect for a wide variety of reasons (see Figure 2).

Figure 2: Reasons for Failure of Segmentation Models

Source: Capgemini Consulting analysis

One of the foremost causes for the failure of segmentation is lack of clarity in business guidelines for the organization. For instance, R&D teams are given the mandate to build products that can sell strongly while marketing efforts are focused on the most profitable current products. This leads to efforts being expended in different directions reducing or nullifying effectiveness.

When it comes to mapping customer value, most managers oversimplify the customer decision process, resulting in vaguely defined rational and emotional criteria of the customer buying process. As a result, the customer segment does not reflect real customer behavior and diffuses the efforts of segmentation

If an organization's value proposition arrived at after a segmentation model is not backed up with operational capabilities, then the activity fit is misaligned, again leading to wastage of valuable resources. For instance, the low-cost luxury airline Silverjet launched services in January 2007 with a focus on the business flyer segment. Though the company saw strong uptake within its targeted segment initially, operationally, it was unable to keep its costs under control, and had to ground its flights by May 2008.[2] Another issue with many organizations is that they are internally focused and do not assess their positioning from a competitive standpoint of market opportunity and threats, thus failing to project themselves differently to the customer.

A key activity commonly disregarded is laying down the metrics to measure the effectiveness of segmentation; this prevents the learning to feed back into the existing process. A recent survey conducted in North America to check the biggest challenges faced by marketing professionals during segmentation reveals that about one fifth of the professionals surveyed highlight the inability to measure segmentation performance as a challenge to segmentation.[3]

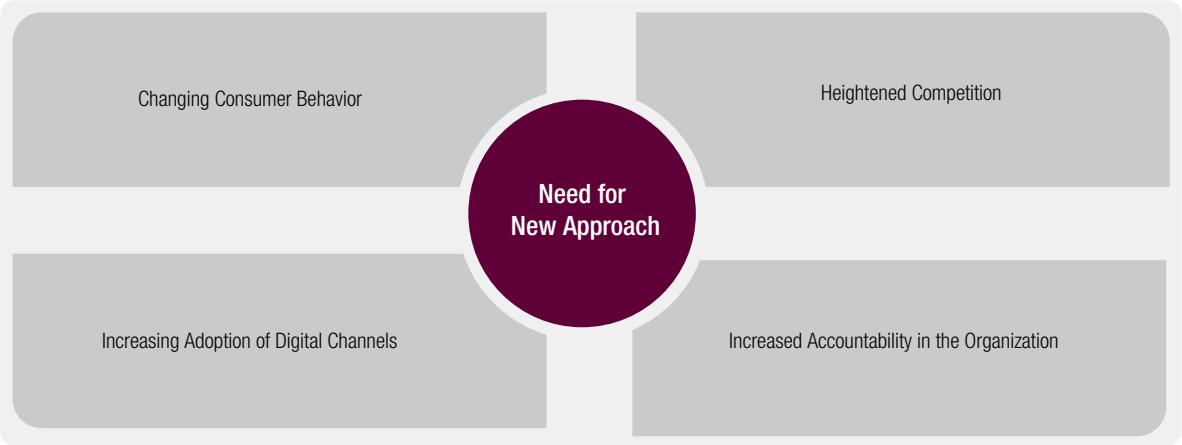
While multiple challenges exist with current approaches, there are other related developments that are collectively forcing organizations to take a re-look at their approach towards segmentation. We take a look at some of these developments in the next section.

The inability to measure segmentation performance is a significant challenge to the segmentation process

Need for a New Approach

Segmentation models have been undergoing a gradual change over the course of the years. However, as segmentation becomes more data-intensive and consumers start exhibiting more flexibility in their consumption patterns, the need to re-look at segmentation is becoming imperative. Changing technology and consumer landscape, heightened competition and the growing focus on increased accountability in organizations are the key factors driving the need for new approach to segmentation (see Figure 3).

Figure 3: Key Drivers for New Approaches to Segmentation

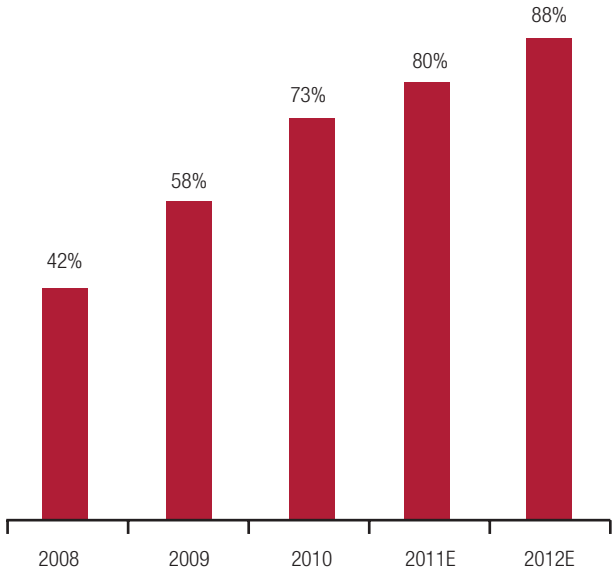


Source: Capgemini Consulting analysis

Increasing Adoption of Digital Channels

With the advent and growth of the digital medium, the relation between organizations and customers is witnessing a transformation. Customers are increasingly using technology in their day to day activities, leading companies to rethink the channels to use to reach them. For instance, it is estimated that web-based channels are now the primary consumer media channel with over 60% accessing the medium daily compared to other established mediums such as TV, radio, newspapers and magazines.[4] This growing adoption of digital channels has an impact on customer spend thereby helping in creation of new market opportunities for companies to attract and capture customers. Businesses are also quickly realizing the growing power of digital mediums in the form of huge amounts of unstructured social insight data. Many are taking up digital mediums particularly in the form of social media, a very visible and powerful tool, to engage with customers (see Figure 4). This facilitates one-to-one marketing, where segments constitute customers for every interaction instead of a group of customers with similar transactions.

Figure 4: Percentage of Companies using Social Media Tools for Marketing Purposes, US, 2008-2012



Source: eMarketer, 'How Many Marketers Are Using Social Media?", Dec 2010

Changing Consumer Behavior

The drivers of consumer value are becoming increasingly fragmented as the choices available to consumers continue to grow and widening access to information provides consumers with more control over their purchase decisions. Consumers can no longer be segmented purely on the basis of a few attitudinal and/or behavioral variables. Understanding the consumer in the digital age requires the ability to determine their rational and emotional requirements at each key point of interaction (i.e. moment of truth) along the decision cycle. As the battleground of competition shifts from the product to the overall customer experience, marketing managers need to find creative ways of segmenting customers on the basis of not only what the consumer buys from them but also how they buy from them.

Heightened Brand Competition in the Marketplace

Growing pressures on organizations to cut costs, increase process efficiency and to offshore brings homogeneity in operations, resulting in a positioning that is not too different from the competitor. Organizations are thus finding it increasingly challenging to differentiate themselves from competition. Customers are being inundated with the same message by different organizations leading to fragile competitive advantage. For instance, in the US, a recent survey indicates that customers perceive zero differentiation between bank brands.[5] With customer experience becoming the core driver to measure the value derived from customers, it is critical for organizations to differentiate themselves on the experience they provide to customers.

Increased Accountability in the Organization

There is a growing focus on the need for decision makers in organizations to be data-driven. The advent of digital tools enables segmentation solutions to be accountable and measurable. Earlier, decision makers were faced with the challenge of lack of right or sufficient data to evaluate the efficacy of their segmentation models. However, with advanced digital tools the challenge is not what data to use but what decision to make, thus bringing increased accountability within organizations as decisions can now be clearly traced back. Moreover, research has indicated that a clear focus on data-driven decisions has a positive impact on both employee productivity and company financial health. For instance, a research study from MIT indicates that organizations that follow data-driven decision making see over 4% higher productivity and 6% higher profits than their peers.[6]

These developments are prompting organizations to seriously re-think their approach to segmentation. In the next section, we propose measures that can help businesses in creating actionable segmentation models that are suitable for the digital age.

Winning at Segmentation

Segmentation is ultimately about 'winning' which starts with knowing something about your customers that your competitors don't. Traditionally, segmentation schemes have relied heavily on background variables including demographics, psychographics, and purchase needs. However, since such approaches often make questionable assumptions about the relationship between these attributes, they are likely to create segments that don't really vary in terms of their behavioral reactions to different marketing stimuli. Organizations that have experimented with needs-based segmentation often complain of segments that are heterogeneous in membership, complicated, difficult to target and fail to provide a predictable model of customer behavior.

In order to maximize the value of segmentation, organizations need to break away from conventional measures of the market and adopt more innovative approaches. Advanced analytics, powerful software and an increasing number of channels to gather consumer insights enable organizations to build and act upon a more comprehensive and privileged view of their customers' needs, wants, and behaviors. The current trend in segmentation is to classify customers based on their actual behavior at each critical point along the purchase cycle. In other words, segmenting customer based on the things they do and value at each point of interaction (i.e. experience focus) rather than simply what they do and value at the point of transaction (i.e. product focus). Moreover, rather than focusing on explanatory measures of why a customer did what they did, organizations need to use advanced analytics and enhanced data files to predict, based on common behavioral patterns, what a customer is likely to do next.

Organizational thinking on segmentation needs to be viewed through the lens of the new digital ecosystem with its enhanced scope of value creation and how it impacts the requirements for an effective, actionable segmentation and targeting. Value generated both to the organization and the customer are the pivot on which the decisions of segmenting, targeting and positioning depend.

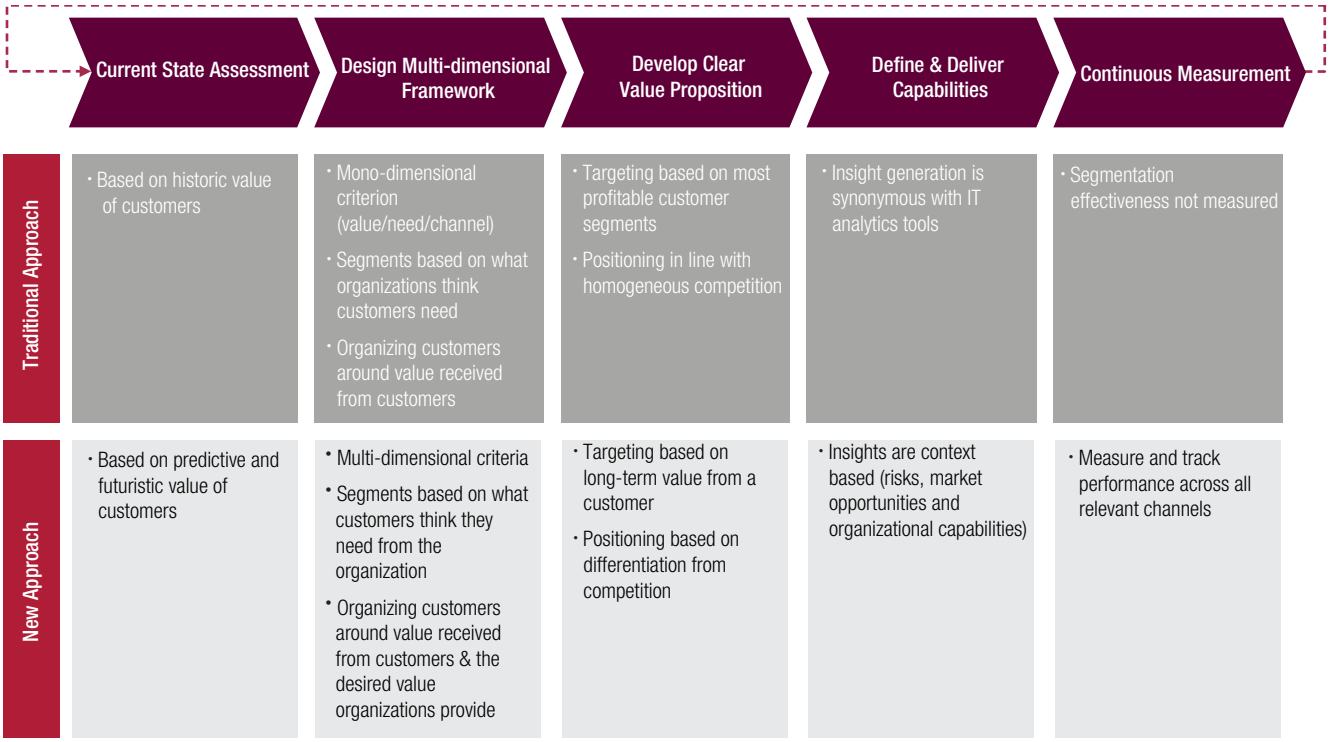
A key focus area for effective segmentation is the changing construct of value. While traditional models tend to treat value as the direct financial worth of the customer, the current ethos is to calculate value as a combination of spend plus influence. This takes into consideration not only what customers spend themselves but also the amount of influence they have over the spending habits of those within and beyond their own trusted networks. The rapid growth of the social web has created an army of Super Influencers whose total net worth far outweighs what they might personally spend on products and services.

Though traditional forms of segmentation encapsulate multiple characteristics that differ between customers, effective treatment strategies in the new context can only be met by a segmentation approach that surpasses the traditional mono-dimensional methods of value-based, need-based and channel-responsiveness. Effective segmentation considers not only what's important to the organization but also what's important to the customer. This requires a deeper understanding of the rational and emotional benefits a customer seeks, not only through the goods and services they purchase but also at each critical point of interaction, before and after the purchase is made. The intersection between this 'Value To' and 'Value From' represents a region where the expectations of customers are being met successfully and that success results in an increase in the considered value of a particular segment.

Effective segmentation considers not only what's important to the organization but also what's important to the customer

Segmentation delivers benefits only when a clear intent of its usage is established and the associated impacts on capabilities are addressed. The process should begin with benefits followed by the impact it has on the organization. A structured approach enables the complexity of segmentation to be addressed in components. To design and deliver successful segmentation, organizations need to follow business and customer centric principles that flow from design based on the above notions of value, to action steps that are described below. The principles are spread over five major clusters of the segmentation process (see Figure 5).

Figure 5: Five Step Method of Segmentation



Source: Capgemini Consulting analysis

Comprehensively Assess the Current State

Before initiating any segmentation process, it is essential to make an assessment of the current state of segmentation market coverage, align segmentation with strategic objectives and the operating model. An 'as-is' view of the competitor's market presence and leading practices is to be evaluated so that organizations do it differently. This business-centric design principle determines the firm's competitive position relative to industry through financial intelligence parameters such as size, market share, average revenue per user and impact on profitability. Moreover, the analysis of the current segmentation model identifies execution problems and root causes from the user perspective. Management should utilize the large amount of data collated by marketing through research and surveys to understand what customers actually want. For instance, one of the main reasons for the success of ready-to-assemble furniture maker Ikea is the fact that the company assessed the large furniture market and targeted the over-served, over-priced and under-served, under-priced segment. The company successfully focused on the needs of its customers who are young but not wealthy, who are likely to have children but no nanny to help, and who shop at odd hours as they work in the regular hours for a living[7].

Design a Context-based Multi-dimensional Segmentation Framework

Once segmentation criteria are drawn based on the 'Value From' and 'Value To' an organization, a segmentation model aligned with customer needs, organization's capabilities and overall corporate strategy has to be defined. Both qualitative and quantitative approaches are required to define a segmentation model that is feasible and relevant to the organization. This ensures that not only observable customer usage patterns but also unobservable purchasing patterns of groups are brought to the front in a shared value blueprint.

With the increase in collaboration platforms in the business landscape, not only should the customer's relationship to the organization be considered but the value generated through their relationship to other customers and third parties should also be taken into account. Digital tools need to be utilized to combine unstructured data from multiple sources with structured information, after segments are built, to provide a 360-degree view of the customer.

Organizational acceptance is critical for successful segmentation; anticipating and deciding the extent to which segmentation will be used in the business allows for purposeful design, as well as raising awareness and understanding among the stakeholders.

An example of successful drafting criteria that translated into customer growth is Philips. The company undertook a segmentation exercise that identified five key segments viz. home, office, outdoor, industry and shops. Collectively, these segments covered about 82% of the market. Following the new segmentation exercise, Philips undertook an overall restructuring of the company and was able to increase its brand value from $5.9 billion in 2005 to over $8.1 billion in 2009. While multiple factors have contributed to this increase in brand value, it is highly likely that selecting the right segmentation model gave Philips a strong boost[8].

Develop a Clear Value Proposition

After assessing the current state and designing a segmentation framework, it is necessary to identify qualitative and quantitative benefits accruing to the customers and the business. Customer segments that have unsatisfied customers or customers whose purchasing patterns can be met need to be identified and chosen from the 'Value From' and 'Value To' criteria. Each of these segments features a distinctive proposition and benefits to the customer. For the business too, they also need to characterize how the value opportunity could be realized taking into consideration current or potential capabilities. Companies with large product portfolios may have both more flexibility and more constraints on using segmentation. Irrespective of this, the key question is to identify target segments and positions that leverage the unique strengths of each product, while minimizing overlap and potential cannibalization with the other product positioning.

Digital tools need to be utilized to combine unstructured data from multiple sources with structured information to provide a 360-degree view of the customer

For example, Royal Bank of Canada designed a value-based customer experience blueprint looking for sub-segments with a strong potential for rapid income growth. After identifying a credit-strapped sub-group and programming a specific proposition to address their need, RBC's market share in the market for this sub-segment shot up from 2% to 18% and earned 3.7 times higher revenue per client than that of the average customer[9].

Define and Deliver Capability Requirement

Capabilities within the organization have to be detailed using value derived and value delivered. Processes across the value chain such as people, marketing, R&D, distribution, sales and technology have to be realigned to meet the positioning chosen. Changing an organizational business unit from geography-based to product-based does not necessarily mean redesigning the technology infrastructure. With cloud technology, central databases can be modified and archived virtually across geographies and product-based operating units. For instance, it is important for firms dealing with growing customer base using social networks to understand the growing use of Internet community sites and their potential to influence purchasing decisions locally and globally.

Measure Continuously

While the above four broad clusters help provide the basis for an effective segmentation model, it is also necessary that the segmentation approach adopted is a continuous process and does not outlive its applicability. To ensure this, a measurable baseline and results tracking system needs to be established. The metrics should be customer centric for each segment indicating the effectiveness of the segmentation model against the planned business objectives. In addition to customer-centric metrics, the measurement system should define a set of financial and operational metrics for each segment, and establish effective and measurable goals. These metrics could include revenue, revenue growth, profit, customer satisfaction, channel penetration (percent of revenue generated from channel purchases) and customer buying frequency.

Further, for each of these metrics, moving averages and trends for each segment variable provide a comprehensive view on performance and predictive efficiency of the segmentation model. This enables performance measurement of each segment and adjustment of the segmentation approach over time, as market conditions change decision-making throughout the organization.

Quantitative metrics need to be established in order to ensure that the segmentation approach adopted is a continual process and does not outlive its applicability

Conclusion

Managers looking for a better way to segment markets must once again address the question that is most important and fundamental to this discipline – what is it that makes customers truly different? To get an answer to this question, managers must look beyond the commonly used internal classification schemes and understand that markets are naturally segmented – from the customer's perspective – based on what they want a product or a service to do for them.

In order to maximize the value of segmentation, organizations need to break away from conventional measures. Advanced analytics enable organizations to build and act upon a more comprehensive and privileged view of their customer's needs, wants, and behaviors. Going forward, managers will need to take into consideration digital influences in every activity of the segmentation process.

Segmentation will also need to be more contextual with rapid change in technology adoption, rendering the right offer at the right place at the right time. Segmentation will thus go beyond the traditional 'what and how' a customer buys to understanding the changing value dimensions.

Successful segmentation requires more than just good data and robust analytical model. It aims at cognizing, identifying and organizing customers around the determined value an organization receives and the desired value the organization provides. Increasing share of value created outside the organization and the influence of digital age on customer buying behavior together determine the effectiveness of the segmentation model.

Organizations need to reconfigure the operating processes along the value chain, modifying capabilities and technology support along the way. However managers need to be careful not to regard segmentation as a superior exercise by itself, considering its pervasive impact and usage in the value chain. Superior segmentation is not a substitute for sound business judgment, the ability to generate discrete insights and developing capabilities. Segmentation should encompass the entire organization; understanding the customer should be a way of life and a fundamental driver of shareholder value.

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