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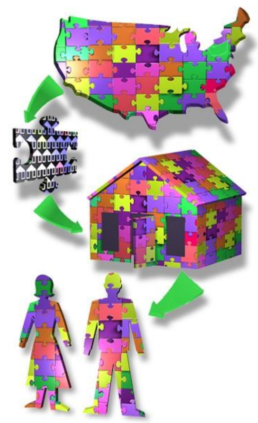
Customer Segmentation: The Most Powerful Marketing Tool

Perhaps the most powerful—and underused—marketing tool available to media, cable and telecommunications companies today is segmentation: the ability to identify high-opportunity customer groups within your marketplace.

Segmentation is based on the precept that not all customers are equal. Some can't live without your product; others couldn't care less. Some customers are highly profitable; others are only marginally profitable or even cost you money.



Market segmentation allows you to focus your scarce marketing resources and appeal to potential customers in ways that are most likely to get them to become loyal customers.

Using segmentation, you can speak to the needs and interests of different groups; you can determine whether there is a product/service fit in high-opportunity segments; you can weigh whether product enhancements or new products might appeal to targeted groups.

Marketing to specified segments doesn't necessarily mean that you target one "best" segment and exclude others. It means that you know how each segment is likely to react to an offer, a price, a promotion or product enhancement, and with that knowledge you can craft a strategy that gets the best possible response from each segment.

Market segments provide the building blocks for long-term growth and profits.

Segmentation Defined

The goal of a segmentation system is to identify groups in which the customers are as much alike as possible—and greatly differentiated from customers in other segments. If the segmentation system is well-designed, members of a segment have similar interests, attitudes and behaviors, and they will respond similarly to elements of the marketing mix such as pricing, promotion and sales channel.

All consumer markets contain many subgroups of customers and prospects who behave differently, have different hopes, fears and aspirations, and have different purchasing behaviors. Segmentation enables a company to craft individual marketing plans that hit the "hot buttons" of each consumer group.

Segments can be developed from many variables that explain and predict consumer behavior: buying or usage habits, demographics, geodemographics, price sensitivity, lifestyles and media consumption. Most customer surveys contain a wealth of data that can be used to

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develop a segmentation system. Your company's own information—internal sales data, direct marketing databases, and customer records--are another gold mine of information.

What isn't a segment?

Subgroups of the market aren't necessarily segments. For example, the subgroup of women aged 25 to 45 may not be a market segment. A subgroup is considered a market segment only if it can be defined as different in needs, values or desires from other groups, and its members respond to particular marketing programs in ways that differ from responses by members of other groups

Without good statistical research tools such as clustering, CHAID and CART, defining effective segments is difficult, if not impossible. Segmenting consumers only by age or income is often misleading, particularly if there are other variables such as family status, occupation and home ownership that interact to play a role in determining purchasing behaviors.

The reality is that different segments of the market do have different interests and behaviors and will have different responses to offerings – products, price, promotion and sales channels. Effective marketing looks at segments as building blocks, with each handled differently in order to build the entire customer base. It's far easier to deal with the needs and interests of smaller groups separately in a "building block strategy" than to try to serve an entire market with a "one-size-fits-all" approach.

Benefits of Segmentation

A well-designed and efficient segmentation system provides a common marketing framework for the entire company. Managers in all departments can analyze and understand the market—down to the individual household—and develop coordinated plans to improve the company's performance in the most valuable segments. The key elements of segment performance include market share, acquisition, retention/churn, profitability and customer satisfaction. Segmentation has four major benefits for organizations that want to improve market performance:

1) Identify opportunities in each segment using "gap" analysis

2) Improve average retention and profitability of customers on a segment-by-segment basis.

3) Implement individual marketing plans for each targeted segment

4) Enhance product/service fit in targeted segments.

1) Identify Opportunities with Gap Analysis

The ability to accurately determine the size of a market and then budget sales is a fundamental benefit of an effective segmentation scheme. An effective marketing technique is called "gap analysis." Gap analysis means asking, "How many customers do we have today, and how many more qualified prospects are available in each relevant consumer segment?" "Qualified" means prospects whose characteristics make them likely candidates to become and remain customers.

Using segmentation, a company can calculate how many subscribers are in each segment, and how many more "look-alikes" exist in each segment—the gap. Once the gap in each segment has been determined, the organization can take actions to close the gap.

By using the segmentation system to take "snapshots" of the customer database at regular intervals, a company can quickly determine which segments are growing, remaining static or declining.

Gap analysis also provides a fact-based method to set realistic customer acquisition goals. It can lead to a budget—based on specific assumptions about the size and opportunity in each segment—that's realistic and achievable.

Gap analysis also can be used to identify under-penetrated but potentially profitable small geographic areas such as Zip Codes and Census tracts and block groups. Segment codes can be attached to these geographies using a technique called "geocoding." Then the company can identify geographic areas with good purchasing demographics, but relatively low penetration.

2) Improve Customer Retention and Profitability

A second powerful use of segmentation is the ability to look at the loyalty, or average retention, of each consumer segment. Using new information technologies, such as multidimensional analysis, a company can calculate retention by weeks or months for each subscriber in a segment and then identify which segments are very loyal, marginally loyal, or likely to churn or not pay. A company's marketing department can identify the various components of churn to find out what operational or marketing factors are working against loyalty. It is also possible to calculate churn on an individual segment to set more accurate new customer acquisition budgets.

Understanding the dynamics of loyalty is a major component for building revenues and profits. For many companies a five-percent improvement in average 52-week retention is can increase the net present value of the customer base by more than 80 percent.

Most companies could reap major benefits with a marketing strategy focused on retention. Measuring and tracking retention on a segment-by-segment basis opens up great opportunities for cross-departmental efforts, such as more effective marketing actions and product enhancements, to dramatically improve acquisition and retention performance.

The combination of penetration gap analysis, propensity-to-purchase indexes and retention indexes can and should guide targeting strategies. It's logical to first target segments that have a high probability of becoming a customer and also have an inherent degree of loyalty.

Other segments can be targeted in order of opportunity to achieve required acquisition numbers.

3) Use Marketing Strategies Tailored to the Segment

Once the targeting plan is developed, the third major benefit of segmentation kicks in: the company gains an understanding of the characteristics of consumers in each segment—demographics, lifestyles, purchasing behaviors, media consumption and attitudes toward the company's products and services (if available from survey research).

The knowledge of each segment's characteristics enables a company to tailor offers and promotions that have the best appeal prospects in individual segments. The basic elements of the marketing mix—price, promotion, place (sales channel), and product—can be varied to suit the needs of each segment. A company can craft messages and communications that are tailored to the needs and desires of each segment.

Segmentation systems developed using a company's own data and research can also be linked to syndicated research such as Scarborough, NFO or Gallup. For example, Scarborough, available in the top 64 MSAs, has a wealth of information about consumer behaviors for shopping, media consumption, leisure time activities, travel and entertainment. Combining proprietary research with syndicated research in a segmentation system allows the company to create vivid and detailed profiles of consumers in each segment and then tailor the messages and offers to those profiles.

4) Enhance Product/Customer Fit

High rates of churn and poor retention may be symptoms of a product or service that isn't completely meeting customer needs. The fourth major benefit of segmentation—coupled with effective survey research—is to identify opportunities for product enhancements.

Survey questions related to product attributes, customer satisfaction and propensity to purchase can be profiled via indexes (above or below the market average of 100) to clearly indicate the degree to which product enhancements are likely to improve customer acquisition and retention.

Individuals within poorly performing segments can be interviewed via focus groups or primary research to identify possible product improvements or new services that would better suit customers within these segments. Marketing best-practice companies will actively involve customers in the design of new products and service enhancements. Segmentation enables the company to identify those individuals most likely to positively respond to product improvements.

Putting It All Together

As competition heats up, companies must get smarter about whom they are targeting for new acquisition, product/service upgrades and retention. The use of market segmentation should be a fundamental strategy for companies that wish to improve their sales and profit performance. Effective segmentation is one of the keys to improving customer retention. Targeting the right prospects in the first place – those that have a high propensity to purchase and stay loyal – will have a dramatic effect on retention and increase cash flow.