

Advanis White Paper Series: Number 3 – Segmentation

Market Segmentation And Customer Targeting



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Not every dollar spent in advertising and sales effort is created equal. Some of those dollars generate more revenue than the rest of the advertising and sales budget put together. If one only knew beforehand which dollars to spend and which not to spend.

Profit potential varies from consumer to consumer because people's backgrounds, attitudes, perceptions, needs and benefits sought differ. This creates a fragmented marketplace with a diversified demand for goods and services. Any firm operating in such an environment must have an accurate picture of this diversity to develop products and services that consumers actually want, and effective strategies to market them to consumers.

Advanis' approach to market segmentation and customer targeting is a behaviorally based, methodologically rigorous approach that can provide invaluable information about the complex marketplace faced by today's firms.

Through the market intelligence provided by market segmentation, the answers to questions concerning the four marketing P's (product design, pricing, place [channel] and promotion [advertising]) can be obtained.

With the necessary marketplace intelligence available, expenditures on potential customers can be targeted so that profit is maximized.

THE ADVANIS APPROACH TO MARKET SEGMENTATION

The Objectives of Segmentation

The ultimate degree of market segmentation would be to consider each individual consumer as unique, with needs and benefits sought that are a priori supposed not found in anyone else. Cost considerations and common sense dictate that such an approach is (generally) impractical.

The objective of most market segmentations is to find homogenous groups of consumers that have sufficiently similar characteristics to allow us to treat the individuals in each uniformly, insofar as product design and marketing are concerned. An important second objective is to enhance the usefulness of the

segmentation by insuring individuals are targetable (i.e. identifiable).

The degree to which targetability is an issue is dictated by the use to which the market segmentation solution will be put. If the segmentation is being conducted mainly for the purpose of gaining deeper insight into the marketplace, targetability becomes less of an issue.

However, if the purpose of developing the segmentation is mainly to provide direct guidance to marketing and sales actions, finding the high-potential consumer becomes extremely important.

The Behavioral Basis

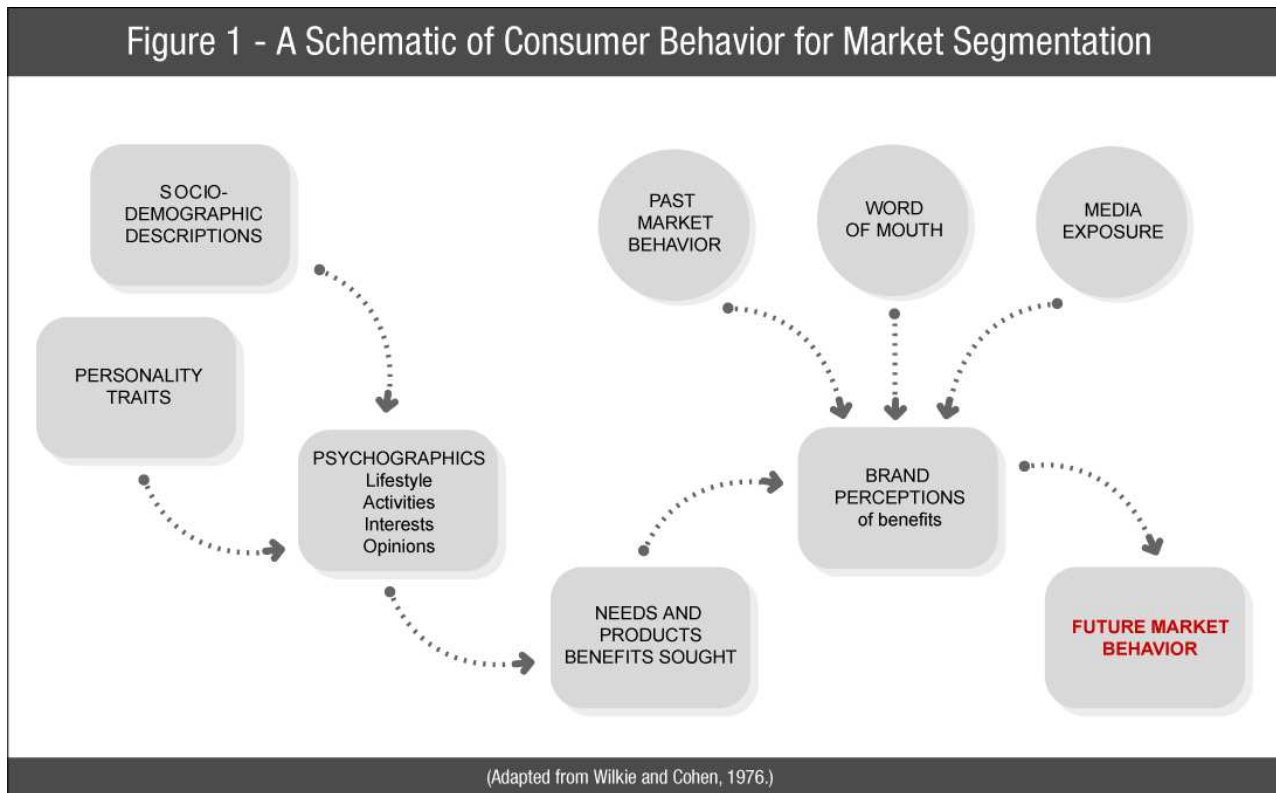
Obtaining helpful and actionable market segments to form the foundation of a marketing program requires having a model of consumer behavior underlying the entire effort. If no such model is guiding a segmentation effort, the only possible outcome is the definition of a correlational segmentation of the marketplace, rather than a behavioral segmentation. The latter type of segmentation is, of course, more preferable since the reasons underlying the solution will become evident, and best of all, should better withstand the test of time as the marketplace changes.

Figure 1 (over) depicts the framework that guides Advanis' behavioral segmentation approach. Each individual decision-maker can be represented by his or her social and demographic characteristics as well as personality traits, all of which combine to define what are known as the psychographics dimensions of the consumer (lifestyle, activities engaged in, interests, opinions, etc.).

These in turn are assumed to define the needs and benefits sought by the consumer with respect to the product class of interest. Past experience with brands, word-of-mouth and traditional media advertising, all contribute to form the consumer's perceptions of how each brand in the marketplace will meet his or her needs and benefits sought.

These perceptions then become one of the principal determinants of future market behavior, along with product attributes, pricing and channels of distribution.

The Behavioral Segmentation Method Used by Advanis



The conceptual model shown in Figure 1 is implemented in Advanis studies through the survey instrument, which includes items pertaining to each of the components therein: sociodemographic characteristics, psychographic information, needs and benefits sought in general, as well as specific brand perceptions with respect to needs and benefits, past market behavior, media exposure, as well as future behavioral intentions are collected from the respondents.

All these pieces of information are used to simultaneously form market segments. However, not all the information is given equal weight in the determination of the segments. The data are divided into two categories, drivers and illustrators. Drivers are the underlying reasons for observed market behavior, and generally will include the needs and product benefits sought, as well as brand perceptions of benefits.

Illustrators are those pieces of information, such as sociodemographic and psychographic characteristics, past behavior and future

intentions, that are either the formative factors of the drivers or are the final result of consumer behavior. These latter data are often used to explain the structure of a segmentation solution, and more importantly, form the basis for improved customer profiling and targeting.

It is often the case that a firm has available information on respondents that cannot be accurately obtained in a survey. An example of this is billing data over some period of time preceding the study. This type of information can also be used to aid in the segmentation of the marketplace, when it is available.

A market segmentation solution that simply groups together individuals who are of a certain income and age category, residing in a certain region of the country and having a tendency to buy certain brands is not of much use to developing a marketing strategy. It is far more useful to group together individuals that have certain common needs and benefits sought through the product category of interest, as well as common perceptions of

brands in the marketplace, and then find out who these individuals are in terms of their income, age, residential location and so forth. This approach will yield interpretable, actionable and targetable market segments.

The method employed by Advanis to combine all these pieces of information to obtain market segments is based on correspondence analysis (a factor analytic method specifically designed to handle categorical data, such as found in market research surveys; see Greenacre, 1984, Kaciak and Louviere, 1990) together with hierarchical clustering techniques. The use of correspondence analysis (CA) is what permits all these diverse data sources to be combined to obtain the market segments. Other techniques are not so flexible since they either cannot handle categorical data, or require untenable assumptions to do so.

CUSTOMER TARGETING

As was indicated earlier, many applications of market segmentation require that we subsequently be able to classify individuals in the marketplace into the segments obtained. This is most often the case when we wish to employ the segmentation to directly aid the sales and advertising efforts of the firm.

A typical application would occur in direct marketing efforts, such as catalog sales, where it is desired to increase the cost-effectiveness of a mail-out by targeting only high-potential consumers. Similarly, direct sales efforts, whether in person or by telephone, can be more effective if we limit efforts to those areas where high potential consumers are more likely to reside.

Once a segmentation has been obtained, Advanis can proceed to the second stage: customer targeting. The objective of this is to produce a classification model that permits one to predict the likelihood of an individual in the population being in each of the segments already defined. Clearly identifiable characteristics (principally information available in the survey and in a company's databases are used) are used to develop these classification models. An interesting variant of this basic technique can be used to guide geographically-based sales organizations. Specifically, the classification

model is based on census block level information, obtained by geocoding respondents' locations. It is then possible to use the classification model to predict the market segment composition of any arbitrary census block. These segment composition predictions can be aggregated as necessary. Sales efforts can then be targeted at regions that contain higher percentages of individuals in high-potential segments.

ESSENTIAL TEAM WORK

Market segmentation is not a cut-and-dry technique that embodies a black box out of which is spewed some magical solution. Instead, a solid methodological basis, allied to experience and market knowledge, are essential to obtaining useful, actionable and targetable segments. It is essential that the client and the consultant work as a team to develop a segmentation solution. The development of a successful market segmentation requires all parties "buy in" .

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