Avoid the segmentation trap

An Experian Marketing Services White Paper

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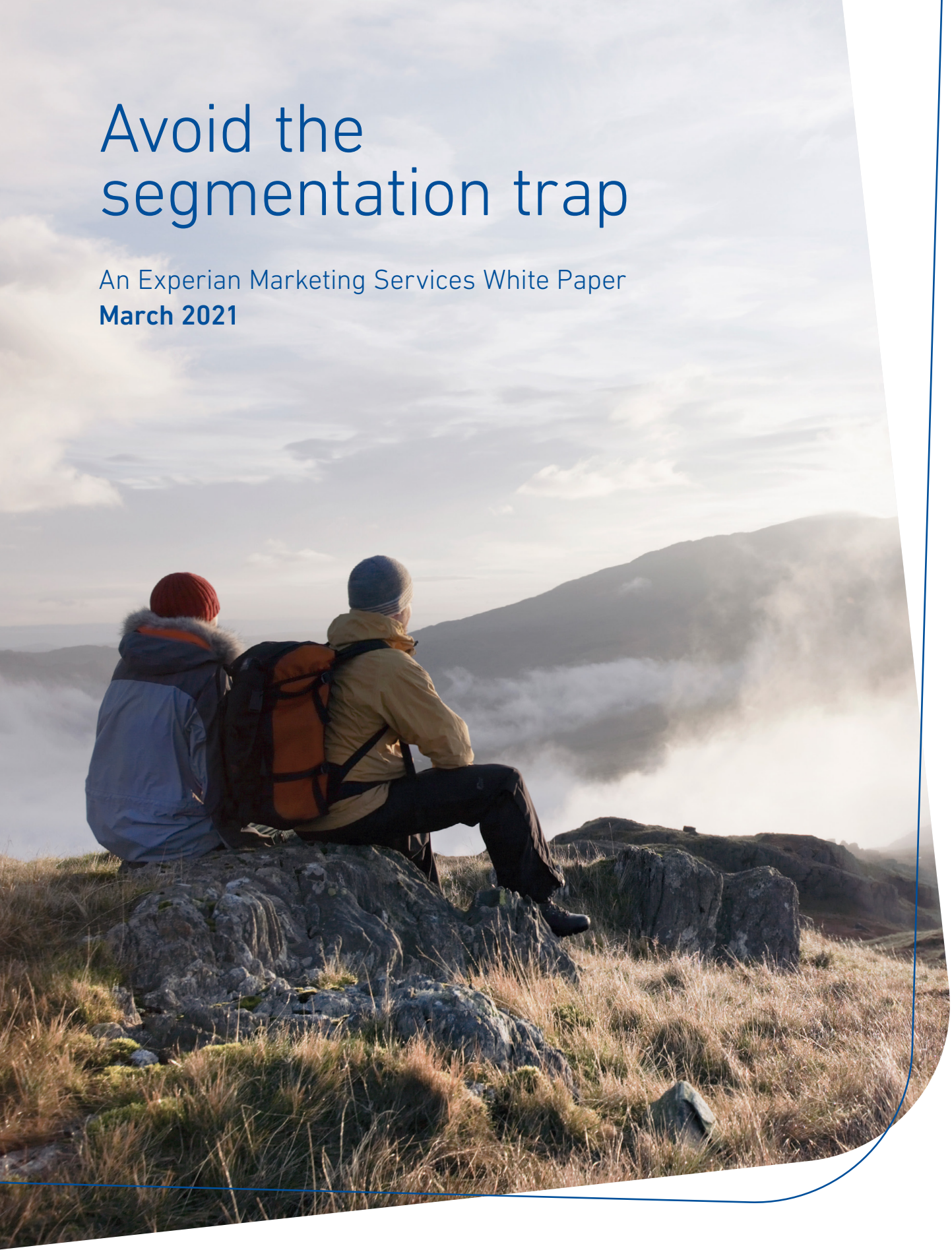

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Executive summary

- Segmentation is a powerful technique, but it can be misunderstood and misused.
- Therefore it's important to have a clear idea about what segmentation should be used for.
- An 'anchor' segmentation is feasible, but is best anchored by value not needs, making it useful for profit and loss decisions.
- Research-based attitudinal segmentation can be dangerous, particularly if senior executives use it as shorthand for all customer behaviour and all subsequent marketing.
- Needs-based segmentations created from research are very difficult to match with an existing customer database.
- In most organisations, a 'primary state,' frozen segmentation lasts about as long as the marketing director's tenure.
- Multi-dimensional, dynamic segmentation is much more effective – it may be challenging to create, but it will be less painful in the long run.
- It's important to recognise the limitations of segmentation for activities like value and campaign management (when to segment, when to optimise, when to target).
- This article identifies the top 10 segmentation traps that businesses fall into, and how to create a successful segmentation strategy.

1. Introduction

Of all the activities in the business cycle, the segmentation initiative is always the most predictable – in its approach, its lack of success and its perpetual recurrence.

Perhaps the arrival of a new Marketing Director or a compelling pitch from strategy consultants sets the ball rolling. The initiative then begins to snowball, taking up large amounts of resource, but never reaching full completion. It all lasts until the Marketing Director leaves, when it's abandoned in favour of a new one.

Cynical? Probably. Segmentation undoubtedly can have many benefits, but all too often it's used to define business strategies, rather than as a tool-set to achieve them. After all, every company worth its salt has used customer segmentation a number of times. But how many have made it truly profitable?

Most examples have been disappointing, and a significant number have actually impaired business performance.

"Segmentation undoubtedly can have many benefits, but all too often it's used to define business strategies, rather than as a tool-set to achieve them."

2. The 10 Common Traps of Segmenting Customers

Segmentation is a powerful technique, but it can be misunderstood and misused. Therefore it's important to have a clear idea about what segmentation should be used for.

2.1 Segmentation is the action – not the objective

Think of segmentation as a verb, a 'doing' word. It has to stem from clear objectives and strategy. All too many businesses are still picking through the leftovers of static, research-based segmentation projects based on little more than executive philosophy. With no financial modelling to back them up, no wonder these projects failed.

Of course, some people claim that sexy segmentation has actually improved performance – take Tesco, for example. But the evidence appears inconclusive. One could claim that Tesco's success has more to do with a strong value proposition, superior customer experience, wider product ranges, an appealing brand, a strong presence, efficient supply chains and a focus on customer needs.

The Smart Marketer's Handbook (circa 1970) may well say 'segment or die' but that doesn't mean segmentation works – or that it has to be the same for every business.

2.2 Too big to handle

To make segmentation easy to grasp, it's all too tempting to split the marketplace into a few simple customer segments. For instance, five to ten segments makes it all straightforward enough for a business to understand, and large enough to allow economies of scale in product development. However, it's no help with customer management or value engineering.

After all, for any large business, some of the segments could contain millions of consumers. That's hardly 'getting close to the customer'!

2.3 The customer chimera

In Greek mythology the chimera was a fabulous beast with the head of a lion, the body of a goat and the tail of a serpent. Much like the following profile:

Young Fun

- Mix of male and female (40% / 60%)
- One of the youngest segments, but 56% aged over 35. Mean age: 38
- Both single and married
- Over half have children
- Lower social classes, low education
- Tend to be:
  - Manual / factory workers
  - Clerical / office workers
  - Some students
  - Some unemployed

Have you ever met anyone who could possibly tick all these boxes? If you were talking to customers directly about your latest product or service, would you find this information useful? How would you deliver a successful ROI-based strategy to this person?

2.4 The frozen state

Another key requirement of most legacy segmentation approaches is stability. If an organisation is going to create a few large segments and develop propositions for them, the last thing they want is customers jumping from one segment to another.

That means segments are designed to be static, or frozen. Businesses can then measure performance over time and be confident about return on investment. But the awkward customers keep getting in the way. They will insist on changing: age, jobs, homes, marital status, parental status, consumption to name but a few. Fixed state segmentation fails to reflect the dynamic behaviour of customers and becomes increasingly irrelevant in marketing campaigns.

Dynamic Segmentation

- Traditional needs-based segmentation helps develop propositions
- 'What sort of product would this person buy?' – as well as tone – 'How should I approach these types of people?'
- However, segmentation doesn't have to be static but can reflect the complexity of different 'states' that any customer may be in during their relationship with a business.
- Dynamic segmentation is crucial, as evidence shows customer 'state' creates a response or conversion at least six times more effectively than the next strongest factor such as offer, incentive or creative.
- For best practice, it's important to understand and meet a customer's needs dynamically along the customer journey – frozen state segmentation is of limited use.

2.5 Problems with referencing

Market research can be a wonderful thing, but when an individual focus is needed it becomes less helpful. Unfortunately, many companies rush into segmentation by starting with market research. Customers and prospective customers are asked what they want, need and do, and the research project then builds segmentation models.

However, once a company starts referencing these segments back to the existing and prospective customer databases it hits some serious problems:

- The only way to create references, within the rules of the Marketing Research Society on respondent anonymity, is to set up algorithms using common data and recreate the segments on the database. However, if you didn't start with the database itself, there will be very few common items to draw upon.
- The scoring process therefore becomes very unsophisticated and insensitive, and the chance of placing more than 50% of customers into the right segments with anything above 70% probability are quite slim.
- That means companies can spend years (and millions) picking up the pieces.

The solution is to start with your own data, and any data from a third party, to build the segmentation upwards. Once you've identified the key variables, then you can do the market research.

2.6 Differentiation or just different coloured envelopes?

The best segmentation framework in the world will still not deliver a return if a business cannot conceive and execute worthwhile strategies. After all, what's the point in having segments if the customer experience is hardly different across each one?

All too often organisations think the best use of segmentation is in creating different communications for different groups of people. Frankly, if that's your only reason for segmentation, it's not worth the expense. It creates minimal difference, and won't justify the cost. At the end of the day segmentation can only pay for itself by delivering lower conversion costs, higher prices and improved margins.

True segmentation means different propositions for different customer groups, not just different coloured envelopes in their direct mail.

2.7 Poor resource allocation and ROI assessment

All too often organisations allocate resources by product or business function. Yet if you are serious about segmentation, you need to follow a scientific method to allocate resources and assess returns across different segments.

One challenge to this is, of course, the fact that segments are not stable. How can you allocate suitable resources if customers shift segments? The answer for many organisations is to only segment at the macro level, for example:

- By geography
- By sector
- By consumer / B2B

2.8 Segment bleed – this sector is not for you

Segmentation may look good on paper, but customers are forever breaking out of their segments. If someone from the 'Young Fun' segment takes a shine to a proposition developed for 'Grey Professionals,' you don't want to turn their business down. Yet this can ultimately damage a brand, particularly in a mature market.

Take Marks & Spencer, for instance, an established company that tried to reach new markets – on the face of it without understanding segment bleed. It is well known that to capture younger customers from its competitors, M&S decided to introduce new styles of clothing.

Yet there was no clear differentiation from the competition – the store lacked the fashion brand of Karen Millen, the style of Ghost, the choice of Top Shop or H&M and the value of Next. All that was left to compete on was price, but this clashed with M&S brand values. Consequently the stores were left with millions of unsold clothes while competitors were announcing record profits.

It is also well known that this activity damaged the store's reputation with its core customer base, the middle England customer who felt M&S was ignoring them in favour of the younger shopper. M&S has now turned the situation around, but it's been a long process.

2.9 Segmentation isn't monotheism

Some segmentation programs take on a distinctly biblical form, with the philosophy that 'there shall be no other segmentation, but the chosen one.'

This approach is just plain wrong. Segmentation is not a tool, it's a tool-set. Yet if all you've got in your hand is a hammer, everything looks like a nail.

> *"Segmentation is most powerful when it addresses a specific problem. And as most businesses face many problems, segmentation must be multi-dimensional."*

Value, needs, behaviour, product, demographics, customer state, preference, credit – segmentation can take any number of approaches, making your organisation as flexible as possible to meet business challenges.

One hurdle to overcome is the senior executive's preference for simpler, easy to understand concepts. Today's marketer has to be able to explain and demonstrate the benefits of multi-dimensionality against seductively simpler segmentation.

2.10 Organising based on customer segmentation

To become truly customer focused, many businesses flirt with the notion of using segmentation to create an organisational model.

This may be a laudable idea, but it creates serious problems:

- Segments have to be referenced and stable to achieve it, and costs begin to proliferate the more segments you have.
- As revenue and cost-reporting are normally product-based, this then has to be engineered into a segment-based view.
- Allocating resources and customers to segments means setting up complex business rules.

Many businesses attempt a half-way house, creating segment teams (demand) with a virtual Profit & Loss sitting across the business, which remains product-based (supply). This simply creates new problems in turn:

- Such a model requires separate managers with responsibility for P&L in each segment. This is fine for the person heading up the 'Funky & Loaded' segment but not so motivating perhaps for the manager given responsibility for 'Poor & Homeless'!
- More management teams mean higher costs, so often multiple segments are simply bundled up together under one manager, defeating the whole point of the exercise.
- Configurations like this are prone to other issues, including demand-supply conflict, resource allocation and the establishment of meaningful, well delineated and actionable customer segments.

Very few large organisations have introduced truly customer segment-based organisational models. Yet there are many businesses with excellent track records in value management and customer commitment.

> *"The truth is that customer focus delivers success, but you don't have to organise around customer segments to be customer focused."*

3. Successful Segmentation

Multi-dimensional, dynamic segmentation is a much more effective strategy. It may be challenging to create, but it will be less painful in the long run. If you can meet all of the following requirements, segmentation will really work for your organisation.

3.1 Be clear on business objectives and strategies

Before you do anything else, ask yourself what you're hoping to achieve from segmentation:

- Identifying customer needs to make propositions more suitable for them?
- Improving customer profitability by driving up average pricing?
- Identifying new target customers?
- Improving customer retention?
- Identifying opportunities to grow or gain market share?

And if you have segmentation already, why isn't it working? Is it badly structured? Does it reflect your product and service portfolio? Is it central to the business?

Sometimes segmentation is focused on lifestyle rather than products or services. This can be very useful for a new company that needs to know every possible customer. But for existing companies, every customer base will have young, old, retired, business people, etc, so segmenting to lifestyle won't tell you why they choose your business. We all know that young people like entertainment, sport and fashion, but that doesn't offer any insight into why they buy a certain yoghurt, drink or mobile phone.

Instead of new segmentation, your business may just need to make itself more attractive to core customers. Refresh the brand values to align them with your key strengths. For instance, if you are strong in customer service, differentiate your brand accordingly. Use customer research and customer base analysis to identify the strengths to focus on.

3.2 Start with your data

Unfortunately, many companies start their segmentation by thinking about the types of customer they want, rather than looking at their existing customer base. That makes any future customer 'tagging' exercise very complex indeed.

So start by looking at the people who are already buying from you:

- Perform simple data analysis on each product and service, identifying your main types of customer, what they look like and why they buy.
- Once you've identified your main customer groups, define a business goal to acquire and retain more people like them – segments don't need trendy names to work.
- Concentrate on the customers you already have, perhaps improving the products and services they use.

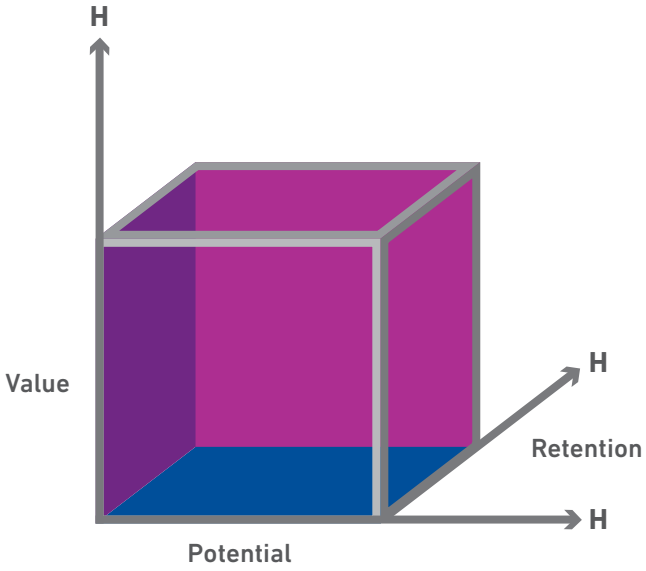
3.3 Focus on value first

There are lots of ways to segment, but it's best to start looking at value. After all, this is why you're segmenting in the first place – to help your business generate more valuable returns.

Create an investment model, using two or three dimensions together. This can help you build a high level portfolio view of the customer base to enable you to separate differentiated value. For instance:
Value: the monthly or annual profit per individual customer (or revenue if profit figures are not available). Average customer value won't help here.

Potential: following propensity modelling at the planning level, this assesses a customer's potential value from up-selling or cross-selling.

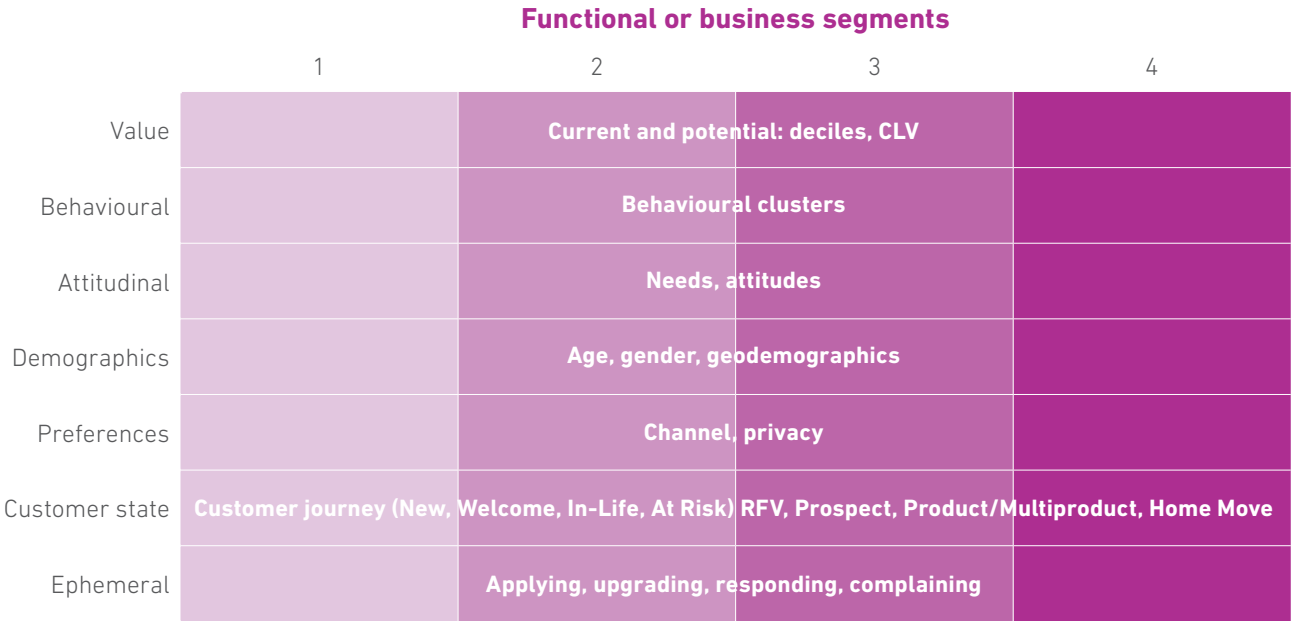
Retention: again using propensity modelling, this maps the likelihood of each customer staying with your business. This lets you cluster customers and create a high-level investment planning strategy:



Segment	Example Strategy
High value, high retention, high potential	Protect and grow
High value, high retention, low potential	Protect
High value, low retention, high potential	Intervene, retain and grow
Low value, low retention, low potential	Avoid
and so on...	

3.4 Create a segmentation tool set

Every business has a number of customer-based problems to address. Relying on just one tool to do this is very risky and could lead to wasted resources. It's much more effective to create a segmentation toolbox, containing different types of segmentation your business can use to tackle different challenges. The diagram below shows just what's possible:



Cross-tabulated, addressable, actionable

- **Value segmentation** – current value, potential value, lifetime value, value deciles, contribution.
- **Behavioural segmentation** – transactional data collected on how customers use products and services, including credit risk.
- **Attitudinal and needs** – core values, needs and reasons customers use products and services, usually identified through market research.
- **Socio-demographic segmentation** – where people live, their age, household composition and lifestyle extrapolations.
- **Preference segmentation** – the channels, privacy and relationship people prefer.
- **Customer state segmentation** – time-based segments, showing a customer's position in an event, process or relationship cycle.
- **Ephemeral segmentation** – segments of one in real-time to take advantage of fleeting opportunities.

You should be able to refer each of these segments to individual customer data, making all segments actionable. Ideally your segmentation tools will also be cross-tabulated, giving you richer, multi-layered segments that help solve specific problems.

For instance:

- **Churn** – propensities within customer segmentation give you a powerful solution, but it is also useful to integrate these with demographics and attitudes.
- **Looking for new customers** – Customer state and behavioural segmentation are much less useful. Use the segmentation toolset to model your best customers and create proxies to identify similar people in data from third parties.

Creating a prospect pool means you can use a multi-dimensional segmented prospect base, just like your existing customer segmentation. This in turn helps you take advantage of time-bound opportunities such as 'enquiring,' 'ready to buy' or 'online now.'

What technique you use depends on your objective. Each organisation will have a different approach, but here are some examples:

Objective	Segmentation technique
Business and marketing strategy	Value, needs, behaviour, customer state
Organisation	Functional (marketing, sales, service) or fixed segment (product, sector, geography)
Broadcast marketing and brand development	Value, needs and attitudes
Product, service, tariff and offering development	Value, needs and attitudes, behaviour, demographics, customer state
Acquisition	Socio-demographics and targeting based on predictive models
Retention	Customer state, including targeting based on specific customer behaviour and / or predictive models, some use of attitudinal
Adoption / cross and up sell	Customer state and ephemeral, including targeting based on specific customer behaviour and / or predictive models

3.5 Blend art and science

The segmentation you use must be able to meet emerging requirements for branding, targeting, privacy, relationship management and fleeting opportunities.

This leads to five broad techniques:

Attitudinal or needs-based segmentation

To build brand awareness and communication strategies among desired customer segments locally or globally.

Preference-based segmentation

To ease growing privacy issues by delivering more of what customers want, when and where they want it.

Dynamic segmentation

To allow your business to identify and move customers between 'states' for a mutually beneficial relationship.

Ephemeral segmentation

To enable segments of one in real-time to harness fleeting opportunities.

Behaviour-based segmentation

Using profitability analysis and predictive techniques to improve your targeting by increasing response rates, revenue and profitability.

Meeting all these requirements takes a careful blending of 'art' and 'science.' If your organisation can achieve it, you will make segmentation really work for you.

4. Optimisation rather than segmentation

Finally, and this may prove controversial, but segmentation is really not the best tool to use for value engineering.

For every dollar you spend you have to make more than a dollar in return. To do this you have to target customers who are most likely to respond, with a product or service they are likely to buy, through a media they are likely to buy from.

Meanwhile optimising acquisition means targeting people who exhibit similar purchasing behaviour to the customers you already have. After all, you want to target customers who are most likely to purchase.

This approach runs completely counter to life stage segment-driven acquisition strategy. 99 times out of 100, strategies based on what you know will return better profits than costly segmentation based on what you think.

"So next time someone tells you that you need to be acquiring 'Sun Loving Beach Bums' or 'Fashion Conscious Trendies,' ask them why you can't just go and get more of the same profitable customers you already have."

Some definitions

- **Segmentation:** the grouping together of customers using behavioural data and statistical techniques.
- **Targeting and selection:** identifying appropriate customers to achieve the best return from a specific business objective (measurable by value, product holding, scorecards or predictive models).
- **Optimisation:** the simultaneous consideration of many variables and constraints to achieve the best possible result for a prescribed business goal.
- **Customer journey:** a technique that maps, plans and manages the sequence of all the interactions that a customer has with a business, using appropriate targeting and segmentation at each point.

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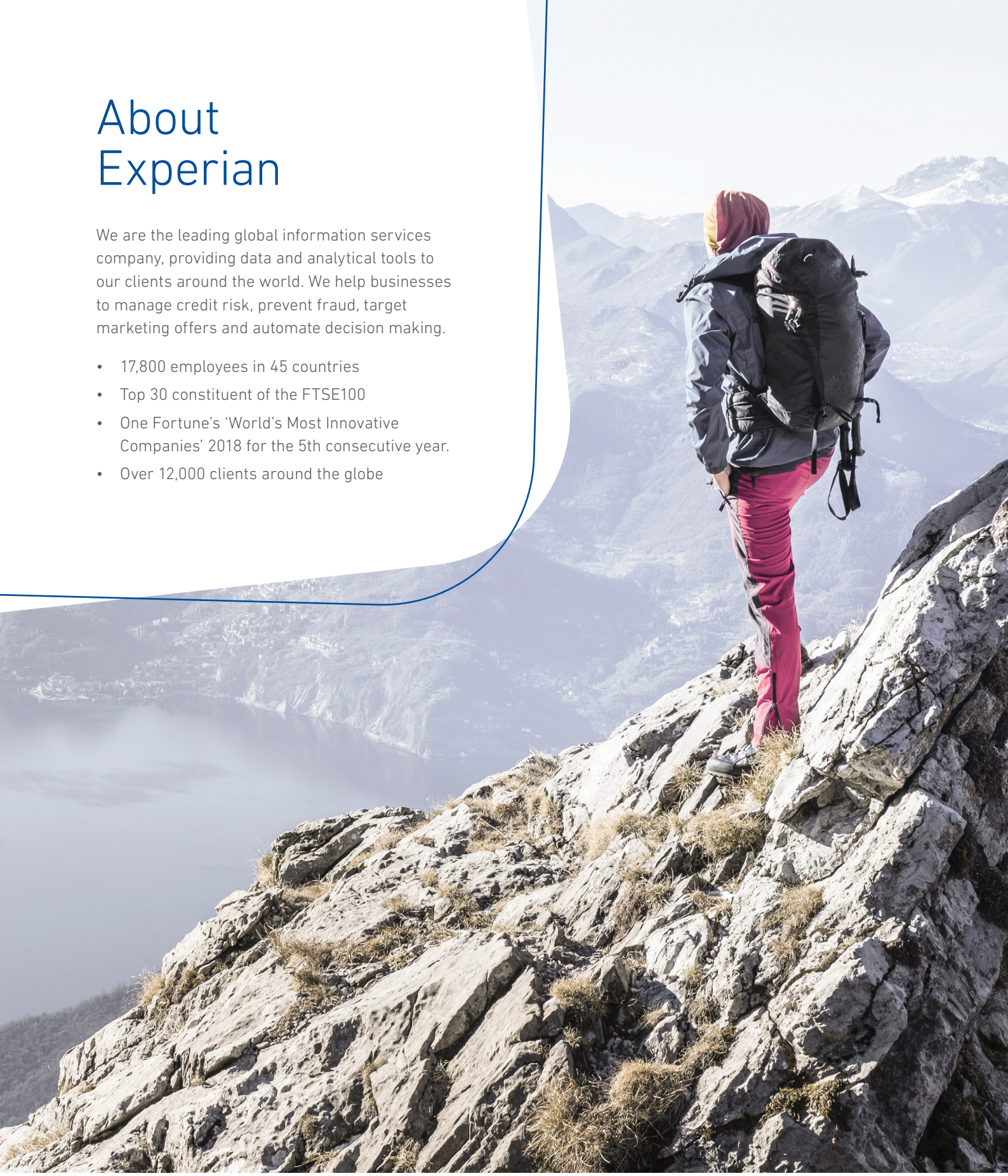

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