Chapter 1
Market Segmentation

1.1 Strategic and Tactical Marketing

The purpose of marketing is to match the genuine needs and desires of consumers with the offers of suppliers particularly suited to satisfy those needs and desires. This matching process benefits consumers and suppliers, and drives an organisation's marketing planning process.

Marketing planning is a logical sequence and a series of activities leading to the setting of marketing objectives and the formulation of plans to achieving them (McDonald and Wilson 2011, p. 24). A marketing plan consists of two components: a strategic and a tactical marketing plan. The strategic plan outlines the long-term direction of an organisation, but does not provide much detail on short-term marketing action required to move in this long-term direction. The tactical marketing plan does the opposite. It translates the long-term strategic plan into detailed instructions for short-term marketing action. The strategic marketing plan states where the organisation wants to go and why. The tactical marketing plan contains instructions on what needs to be done to get there.

This process is much like going on a hiking expedition (Fig. 1.1). Before starting a hike, it is critically important to organise a map, and figure out where exactly one's present location is. Once the present location is known, the next step is to decide which mountain to climb. The choice of the mountain is a strategic decision; it determines all subsequent decisions. As soon as this strategic decision is made, the expedition team can move on to tactical decisions, such as: which shoes to wear for this particular hike, which time of day to depart, and how much food and drink to pack. All these tactical decisions are important to ensure a safe expedition, but they depend entirely on the strategic decision of which mountain to climb.

Preparations for the mountain climbing expedition are similar to the development of an organisational marketing plan. The strategic marketing plan typically identifies consumer needs and desires, strengths and weaknesses internal to the organisation, and external opportunities and threats the organisation may face. A SWOT analysis

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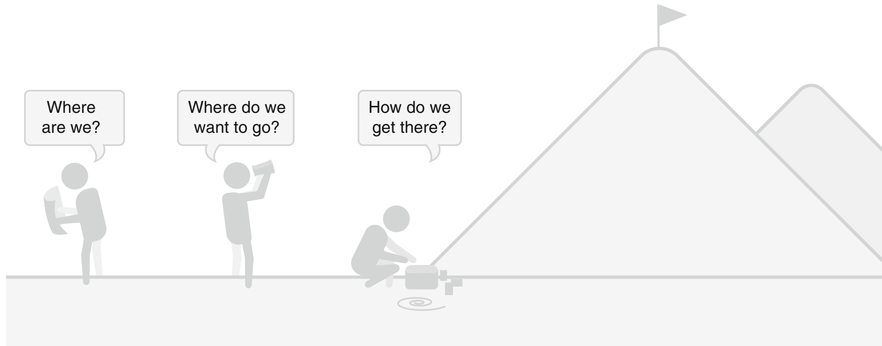

Fig. 1.1 Strategic and tactical marketing planning. (Modified from McDonald and Morris 1987)

explicitly states an organisation's strengths (*S*), weaknesses (*W*), opportunities (*O*), and threats (*T*). As such, the SWOT analysis outlines one side of the matching process: what the supplier is particularly suitable to offer consumers.

The other side of the matching process – consumer needs and desires – is typically investigated using market research. Despite the heavy reliance of market research on survey methodology, a wide range of sources of information are available to explore, and gain detailed insight, into what consumers need or desire, including qualitative research involving focus groups and interviews, observational and experimental research.

Once organisational strengths have been established, potential interference by external factors has been assessed, and consumer needs and desires have been thoroughly investigated, two key decisions have to be made as part of the strategic marketing planning process: which consumers to focus on (segmentation and targeting), and which image of the organisation to create in the market (positioning). These decisions are critical because they determine the long-term direction of the organisation, and cannot easily be reversed.

Only when it has been decided which group of consumers (market segment) the organisation is going to cater for, and how it will present itself to the public to appear most attractive to this target segment, does work on the tactical marketing plan begin. Tactical marketing planning usually covers a period of up to one year. It is traditionally seen to cover four areas: the development and modification of the product in view of needs and desires of the target segment (Product), the determination of the price in view of cost, competition, and the willingness to pay of the target segment (Price), the selection of the most suitable distribution channels to reach the target segment (Place), and the communication and promotion of the offer in a way that is most appealing to the target segment (Promotion).

The tactical marketing plan depends entirely on the strategic marketing plan, but the strategic marketing plan does not depend on the tactical marketing plan. This asymmetry is illustrated in Fig. 1.2 using the mountain expedition analogy. Strategic marketing is responsible for identifying the most suitable mountain to

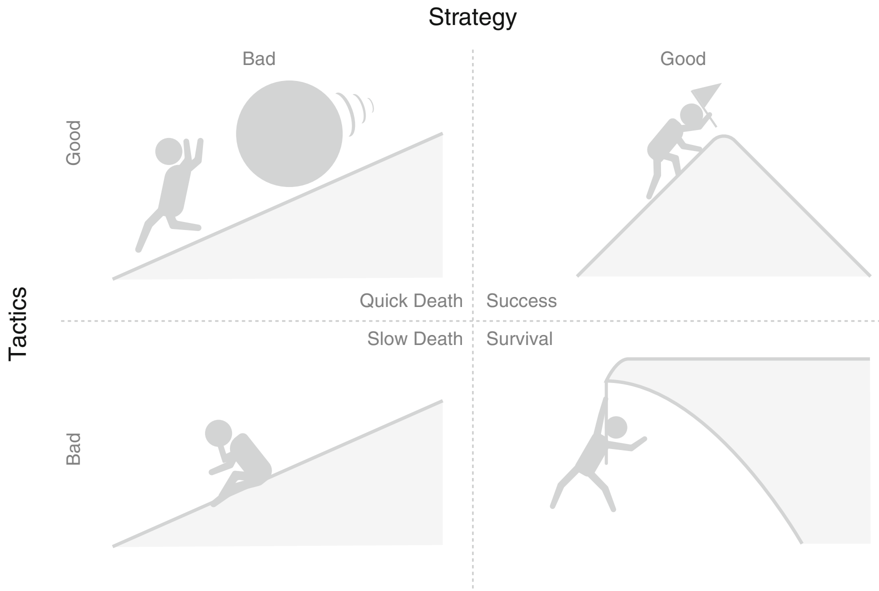

Fig. 1.2 The asymmetry of strategic and tactical marketing. (Modified from McDonald and Morris 1987)

climb. Tactical marketing is responsible for the equipment: the quality of the walking shoes, food, water, a raincoat. As long as the strategic marketing is good, the expedition leads to the right peak. Whether tactical marketing is efficient or not only determines how comfortable (top right hand quadrant in Fig. 1.2) or uncomfortable (bottom right hand quadrant in Fig. 1.2) survival is. If, however, the strategic marketing plan is bad, tactical marketing cannot help. It only affects if the wrong mountain – and with it organisational failure – is reached quickly (top left hand quadrant in Fig. 1.2) or slowly (bottom left hand quadrant in Fig. 1.2).

The combination of good strategic marketing and good tactical marketing leads to the best possible outcome. Bad strategic marketing combined with bad tactical marketing leads to failure, but this failure unfolds slowly. A faster pathway to failure is to have excellent tactical marketing based on bad strategic marketing. This is equivalent to running full speed up to the wrong mountain. Good strategic marketing combined with bad tactical marketing ensures survival, albeit not in a particularly happy place.

To conclude: the importance of strategic and tactical marketing for organisational success is asymmetric. Good tactical marketing can never compensate for bad strategic marketing. Strategic marketing is the foundation of organisational success.

1.2 Definitions of Market Segmentation

Market segmentation is a decision-making tool for the marketing manager in the crucial task of selecting a target market for a given product and designing an appropriate marketing mix (Tynan and Drayton 1987, p. 301). Market segmentation is one of the key building blocks of strategic marketing. Market segmentation is essential for marketing success: the most successful firms drive their businesses based on segmentation (Lilien and Rangaswamy 2003, p. 61). Market segmentation lies at the heart of successful marketing (McDonald 2010), tools such as segmentation [...] have the largest impact on marketing decisions (Roberts et al. 2014, p. 127).

Smith (1956) was the first to propose the use of segmentation as a marketing strategy. Smith defines market segmentation as viewing a heterogeneous market (one characterised by divergent demand) as a number of smaller homogeneous markets (p. 6). Conceptually, market segmentation sits between the two extreme views that (a) all objects are unique and inviolable and (b) the population is homogeneous (Saunders 1980, p. 422). One of the simplest and clearest definitions is that used in a newsletter by Grey Advertising Inc. and cited in Haley (1985, p. 8): market segmentation means cutting markets into slices. Ideally, consumers belonging to the same market segments – or sets of buyers (Tynan and Drayton 1987) – are very similar to one another with respect to the consumer characteristics deemed critical by management. At the same time, optimally, consumers belonging to different market segments are very different from one another with respect to those consumer characteristics. Consumer characteristics deemed critical to market segmentation by management are referred to as segmentation criteria.

The segmentation criterion can be one single consumer characteristic, such as age, gender, country of origin, or stage in the family life cycle. Alternatively, it can contain a larger set of consumer characteristics, such as a number of benefits sought when purchasing a product, a number of activities undertaken when on vacation, values held with respect to the environment, or an expenditure pattern.

An ideal market segmentation situation – for the simplest case of two product features – is illustrated in the left hand panel of Table 2.3 on page 19. The x-axis shows the number of desired features of a mobile telephone, and the y-axis shows the price consumers are willing to pay. Here, three market segments exist: a small segment characterised by wanting many mobile telephone features, and being willing to pay a lot of money for it; a large segment containing consumers who desire the exact opposite (a simple, cheap mobile phone); and another large segment in the middle containing members who want a mid-range phone at a mid-range price. This example illustrates Smith's definition of market segmentation with each of the segments representing one homogeneous market within a larger heterogeneous market.

The example also illustrates why market segmentation is critical to organisational success. A mobile phone company attempting to offer one mobile phone to the entire market is unlikely to satisfy the needs of each of those segments; and unlikely to develop an image in the marketplace that is distinct and reflects an offer

desirable to consumers. Rather, tactical marketing efforts may be wasted because the mobile phone company fails to cater for any of the homogeneous market segments. Selecting one market segment, say the high-end, high-price segment, and offering this segment the exact product it desires, is more likely to lead to both high short-term sales (within this segment), and a long-term positioning as being the best possible provider of high-end, high-price mobile telephones.

Such an approach is referred to as a *concentrated* market strategy (Croft 1994). A concentrated strategy is attractive for organisations who are resource-poor, but are facing fierce competition in the market. Concentrating entirely on satisfying the needs of one market segment can secure the future for such an organisation. It does, however, come at the price of the higher risk associated with depending on one single market segment entirely. An alternative approach, if the capabilities of the organisation permit it, is to pursue a *differentiated* market strategy, and produce three telephones, one for each segment. In such a case, all aspects of the marketing mix would have to be customised for each of the three target segments. A differentiated strategy is suitable in mature markets (Croft 1994) where consumers are capable of differentiating between alternative products. Product variations can thus be customised to meet the needs of a number of market segments. When an organisation decides not to use market segmentation, it is effectively choosing to pursue an *undifferentiated* market strategy, where the same product is marketed using the same marketing mix to the entire market. Examples of undifferentiated marketing include petrol and white bread; they are not particularly targeted at any group within the marketplace. Such an approach may be viable for resource-rich organisations, or in cases where a new product is introduced (Croft 1994), and consumers are not yet able to discriminate between alternative products.

1.3 The Benefits of Market Segmentation

Market segmentation has a number of benefits. At the most general level, market segmentation forces organisations to take stock of where they stand, and where they want to be in future. In so doing, it forces organisations to reflect on what they are particularly good at compared to competitors, and make an effort to gain insights into what consumers want. Market segmentation offers an opportunity to think and rethink, and leads to critical new insights and perspectives.

When implemented well, market segmentation also leads to tangible benefits, including a better understanding of differences between consumers, which improves the match of organisational strengths and consumer needs (McDonald and Dunbar 1995). Such an improved match can, in turn, form the basis of a long-term competitive advantage in the selected target segment(s). The extreme case of long-term competitive advantage is that of market dominance, which results from being best able to cater to the needs of a very specific niche segment (McDonald and Dunbar 1995). Ideal niche segments match the organisational skill set in terms of their needs, are large enough to be profitable, have solid potential for growth,

and are not interesting to competitors (Kotler 1994). Taking market segmentation to the extreme would mean to actually be able to offer a customised product or service to very small groups of consumers. This approach is referred to as micro marketing or hyper-segmentation (Kara and Kaynak 1997). One step further leads to what Kara and Kaynak (1997) refer to as *finer segmentation* where each consumer represents their own market segment. Finer segmentation approaches are becoming more viable with the rise of eCommerce and the use of sophisticated consumer databases enabling providers of products and services to learn from a person's purchase history about what to offer them next.

A marketing mix developed to best reflect the needs of one or more segments is also likely to yield a higher return on investment because less of the effort that goes into the design of the marketing mix is wasted on consumers whose needs the organisation could never satisfy anyway. For small organisations, it may be essential for survival to focus on satisfying very distinct needs of a small group of consumers because they simply lack the financial resources to serve a larger market or multiple market segments (Haley 1985).

Market segmentation has also been shown to be effective in sales management (Maier and Saunders 1990) because it allows direct sales efforts to be targeted at groups of consumers rather than each consumer individually.

At an organisational level, market segmentation can contribute to team building (McDonald and Dunbar 1995) because many of the tasks associated with conducting a market segmentation analysis require representatives from different organisational units to work as a team. If this is achieved successfully, it can also improve communication and information sharing across organisational units.

1.4 The Costs of Market Segmentation

Implementing market segmentation requires a substantial investment by the organisation. A large number of people have to dedicate a substantial amount of time to conduct a thorough market segmentation analysis. If a segmentation strategy is pursued, more human and financial resources are required to develop and implement a customised marketing mix. Finally, the evaluation of the success of the segmentation strategy, and the continuous monitoring of market dynamics (that may point to the need for the segmentation strategy to be modified) imply an ongoing commitment of resources. These resource commitments are made under the assumption that the organisation will benefit from a return on this investment. Yet, the upfront investment is substantial.

In the worst case, if market segmentation is not implemented well, the entire exercise is a waste of resources. Instead of leading to competitive advantage, a failed market segmentation strategy can lead to substantial expenses generating no additional return at all, instead disenfranchising staff involved in the segmentation exercise.

It is for this very reason, that an organisation must make an informed decision about whether or not to embark on the long journey of market segmentation analysis, and the even longer journey of pursuing a market segmentation strategy.

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