MARKET SEGMENTATION

MARKET SEGMENTATION

HOW TO DO IT
HOW TO PROFIT FROM IT

Second edition

Malcolm McDonald and Ian Dunbar

© Malcolm McDonald and Ian Dunbar 1998

Foreword © Sir Colin Marshall 1998

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First edition 1995

Second edition 1998

Published by

MACMILLAN PRESS LTD

Houndmills, Basingstoke, Hampshire RG21 6XS

and London

Companies and representatives
throughout the world

ISBN 978-0-333-73369-1

ISBN 978-1-349-26591-6 (eBook)

DOI 10.1007/978-1-349-26591-6

A catalogue record for this book is available
from the British Library.

This book is printed on paper suitable for recycling and
made from fully managed and sustained forest sources.

10 9 8 7 6 5 4 3 2 1
07 06 05 04 03 02 01 00 99 98

Editing and origination by

Aardvark Editorial, Mendham, Suffolk

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Please note:

1

Successful segmentation is the product of a detailed understanding of your market and will therefore take time.

2

Segmentation is appropriate for those markets where it is essential to combine individual customers or consumers into larger buying 'units' to ensure your marketing activity is both cost effective and manageable.

3

The process as presented in this book is aimed primarily at defining segments in terms of the particular marketing mix each requires. Segmentation at higher levels of aggregation is, of course, possible and many of the principles contained in this book would apply, although in a less detailed form.

Foreword

One of the abiding principles of sound business practice is: 'Know your customer; know your market.'

The objective, of course, is to gain competitive advantage by building sustained customer loyalty, with products and services meeting, quite precisely, the demands of closely defined markets.

As markets have become more complex, so has this essentially basic process of market segmentation. It is the view of many that, in both the manufacturing and service sectors, the art of defining target markets rarely progresses beyond the assembly of somewhat dull demographics. The logical conclusion is that, if everybody is doing the same, differential advantage is difficult to attain.

Now, Professor Malcolm McDonald and Ian Dunbar have peeled away the layers of complexity and confusion to produce a step-by-step guide through the difficult terrain of market segmentation. The value of their book to business people everywhere, is that it offers the kind of practical applications needed in today's intensely competitive marketplace.

SIR COLIN MARSHALL
Chairman, British Airways
January 1998

Preface

This book is the result of a painstaking process of research into the practical difficulties that organisations experience in segmenting their markets.

We discovered that most of the academic work in this domain is prescriptive, with virtually no pragmatic guidelines provided to enable managers to make sense of the confusing array of data and information available to them.

So we developed a process, which we tested on some of the best known companies in the world, amending the process until it was sufficiently robust for us to be able to share it with a wider audience. The result was the first edition of this book, then titled *Market Segmentation: A step-by-step approach to creating profitable market segments*.

Since its launch in 1995, the extensive adoption of our market segmentation process has broadened our knowledge base substantially and enabled us to refine the process and identify where more detailed explanations are required. The result is this second edition of the book which, in addition to containing more examples and extended guidelines, also contains a worked-through case study and a series of worksheets for use by the practitioner.

Although the process as presented in this book enables the segmentation practitioner to follow each step manually, the range of information they may need to consider for some markets can become a distraction. Therefore, to enable practitioners to concentrate on the marketing issues they need to address, rather than be diverted by concerns over the amount of information they need to manage, a PC-based package was developed to support the segmentation process. This package, called *Market Segment Master*, the registered trade mark for this process, has also been refined to reflect the process as it now appears in this book. If readers feel that they would like the help of information technology in segmenting their markets, they can obtain details from Professor Malcolm McDonald, at Cranfield University School of Management, Cranfield, Bedford, MK43 0AL, United Kingdom (fax +44 (0)1234 751806), or from Ian Dunbar at *the Market Segmentation Company*, Chandos House, 26 North Street, Brighton, BN1 1EB, United Kingdom (tel +44 (0)1273 746747, fax +44 (0)1273 737981, e-mail tMSC@BTinternet.com).

Returning to this book, we would like to stress that it is most definitely a practical book which, if used properly, will result in actionable market segments. To achieve this result will require time and resources. It is not a book just for reading. It is for reading and *doing*, and is best used by a team, rather than by an individual.

We both wish you happy and profitable segmentation!

MALCOLM McDONALD
IAN DUNBAR
January 1998

USEFUL DEFINITIONS

Benefit	A perceived or stated relationship between a product feature and what a customer gets that they explicitly need (or want). <i>See also</i> Differential advantage <i>and</i> Feature.
Demographics	Measurable descriptions of a 'population' (consumer and business-to-business).
Differential advantage	A benefit or cluster of benefits offered to a sizeable group of customers which they value (and are willing to pay for) and which they cannot obtain elsewhere. <i>See also</i> Benefit <i>and</i> Feature.
Experience effect	It is a proven fact that most value-added cost components of a product decline steadily with experience and can be reduced significantly as the scale of operation increases. In turn this cost (and therefore price advantage) is a significant factor in increasing the company's market share.
Feature	A characteristic or property of a product or service such as reliability, price convenience, safety and quality. These features may or may not satisfy customer needs. To the extent that they do, they can be translated into benefits. <i>See also</i> Benefit <i>and</i> Differential advantage.
Gap	In marketing terms, the difference between a product's present or projected performance and the level sought. Typically, the gaps in marketing management are those relating to return on investment, cash generation or use, return on sales, and market share.
Gap analysis	The process of determining gaps between a product's present or projected performance and the level of performance sought. <i>See also</i> Gap.
Geodemographics	Attaching a demographic profile to a specified geographic area. <i>See</i> Demographics.
Growth/share matrix	A term synonymous with 'product portfolio' which in essence is a means of displaying graphically the amount of 'experience' or market share a product has and comparing this share with the rate of growth of the relevant market segment. With the matrix, a manager can decide, for example, whether he or she should invest in getting more 'experience' – that is, fighting for bigger market share – or perhaps getting out of the market altogether. These choices are among a number of strategic alternatives available to the manager (strategic in the sense that they not only affect marketing strategy but determine use of capital within the organisation). <i>See also</i> Experience effect.

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Market	A customer need that can be satisfied by the products or services seen as alternatives.
Market segment	A group of actual or potential customers who can be expected to respond in approximately the same way to a given offer; a finer more detailed breakdown of a market.
Market segmentation	The process of splitting customers, or potential customers, within a market into different groups, or segments, within which customers have the same or similar requirements satisfied by a distinct marketing mix. <i>See also</i> Marketing mix. A critical aspect of marketing and one designed to convert product differences into a cost differential that can be maintained over the product's life cycle. <i>See also</i> Product life cycle.
Market share	The percentage of the market represented by a firm's sales in relation to total sales. Some marketing theorists argue that the term is misleading since it suggests that the dimensions of the market are known and assumes that the size of the market is represented by the amount of goods sold in it. All that is known, these theorists point out, and correctly, is the volume sold; in actuality, the market may be considerably larger.
Marketing audit	A situational analysis of the company's current marketing capability. <i>See also</i> Situational analysis.
Marketing mix	The 'tools' or means available to an organisation to improve the match between benefits sought by customers and those offered by the organisation so as to obtain a differential advantage. Among these tools are product, price, promotion and distribution service. <i>See also</i> Differential advantage.
Marketing objectives	<p>A statement of the targets or goals to be pursued and achieved within the period covered in the marketing plan. Depending on the scope and orientation of the plan – whether, for example, the plan is designed primarily to spell out short-term marketing intentions or to identify broad business directions and needs – the objectives stated may encompass such important measures of business performance as profit, growth and market share.</p> <p>Marketing objectives with respect to profit, market share, sales volume, market development or penetration and other broader considerations are sometimes referred to as 'primary' marketing objectives. More commonly, they are referred to as 'strategic' or 'business' objectives since they pertain to the operation of the business as a whole. In turn, objectives set for specific marketing sub-functions or activities are referred to as 'programme' objectives to distinguish them from the broader business or strategic objectives they are meant to serve.</p>

Marketing plan	Contains a mission statement, SWOT (strengths, weaknesses, opportunities and threats) analysis, assumptions, marketing objectives, marketing strategies and programmes. Note that the objectives, strategies and policies are established for each level of the business.
Mission	The chief function of an institution or organisation. In essence it is a vision of what the company is or is striving to become. The basic issue is: 'What is our business and what should it be?' In marketing planning, the mission statement is the starting point in the planning process, since it sets the broad parameters within which marketing objectives are established, strategies developed, and programmes implemented. Some companies, usually those with several operating units or divisions, make a distinction between 'mission' and 'charter'. In these instances, the term 'mission' is used to denote the broader purpose of the organisation as reflected in corporate policies or assigned by the senior management of the company; the term 'charter', in comparison, is used to denote the purpose or reason for being of individual units with prime responsibility for a specific functional or product-marketing area.
Objective	A statement or description of a desired future result that cannot be predicted in advance but which is believed, by those setting the objective, to be achievable through their efforts within a given time period; a quantitative target or goal to be achieved in the future through one's efforts, which can also be used to measure performance. To be of value, objectives should be specific in time and scope and attainable given the financial, technical and human resources available. According to this definition, general statements of hopes or desire are not true 'objectives'. <i>See also</i> Marketing objectives.
Planning	The process of predetermining a course or courses of action based on assumptions about future conditions or trends which can be imagined but not predicted with any certainty.
Positioning	The process of selecting, delineating and matching the segment of the market with which a product will be most compatible.
Product	A term used in marketing to denote not only the product itself (its inherent properties and characteristics) but also service, availability, price, and other factors which may be as important in differentiating the product from those of competitors as the inherent characteristics of the product itself. <i>See also</i> Marketing mix.
Product life cycle	A term used in marketing to refer to the pattern of growth and decline in sales revenue of a product over time. This pattern is typically divided into stages: introduction, growth, maturity,

saturation and decline. With time, competition among firms tends to reduce all products in the market to commodities – products which can only be marginally differentiated from each other – with the result that pioneering companies (those first to enter the market) face the choice of becoming limited volume, high-priced, high-cost speciality producers or high-volume, low-cost producers of standard products.

Product portfolio	A theory about the alternative uses of capital by business organisations formulated originally by Bruce Henderson of the Boston Consulting Group, a leading firm in the area of corporate strategy consulting. This theory or approach to marketing strategy formulation has gained wide acceptance among managers of diversified companies, who were first attracted by the intuitively appealing notion that long-run corporate performance is more than the sum of the contributions of individual profit centres or product strategies. Other factors which account for the theory's appeal are: (1) its usefulness in developing specific marketing strategies designed to achieve a balanced mix of products that will produce maximum return from scarce cash and managerial resources; and (2) the fact that the theory employs a simple matrix representation useful in portraying and communicating a product's position in the market place. <i>See also</i> Growth/share matrix.
Programme	A term used in marketing planning to denote the steps or tasks to be undertaken by marketing, field sales and other functions within an organisation to implement the chosen strategies and to accomplish the objectives set forth in the marketing plan. Typically, descriptions of programmes include a statement of objectives as well as a definition of the persons or units responsible and a schedule for completion of the steps or tasks for which the person or unit is responsible. <i>See also</i> Marketing objectives.
Psychographics	A consumer's inner feelings and predisposition to behave in certain ways.
Relative market share	A firm's share of the market relative to its largest competitor. <i>See also</i> Market share.
Resources	Broadly speaking, anyone or anything through which something is produced or accomplished; in marketing planning, a term used to denote the unique capabilities or skills that an organisation brings to a market or business problem or opportunity.
Situational analysis	The second phase in the marketing planning process (the first consisting of defining the mission and corporate objectives), which reviews the business environment at large (with particular attention to economic, market and competitive aspects) as

well as the company's own internal operation. The purpose of the situational analysis is to identify marketing problems and opportunities, both those stemming from the organisation's internal strengths and limitations, and those external to the organisation and caused by changes in economic conditions and trends, competition, customer expectations, industry relations, government regulations and, increasingly, social perceptions and trends. The output of the full analysis is summarised in key point form under the heading SWOT analysis; this summary then becomes part of the marketing plan. The outcome of the situational analysis includes a set of assumptions about future conditions as well as an estimate or forecast of potential market demand during the period covered by the marketing plan. Based on these estimates and assumptions, marketing objectives are established and strategies and a programme formulated.

**Socio-economic
classification**

A classification of individuals according to their level of income and occupation (or that of the head of household).