Segmentation

Conventionally, industries are defined broadly; the automobile industry, the computer software industry, the shipping industry. But competition tends to occur at more localised levels - within specific product groups and specific national or regional markets which means that we need to segment industries into markets.

Segmentation is vital in determining the most attractive part of a market to enter – or create, and for established firms in deciding how to allocate resources among different segments.

The ability to identify and shift resources to attractive segments can help a company outperform the industry average by a significant margin. In the PC industry, Dell Computers has been highly effective in focusing on products and customer groups that offer higher margins. Its direct distribution model allows it to analyse profitability on a customer-by-customer basis.

Differences in customers and competition between segments may also mean differences in key success factors. In the UK beer industry, competing effectively in the market for standard, keg beer requires cost-efficient operation in the form of large-scale, automated production, national distribution through a network of franchised distributors, and heavy investment in advertising and promotion. However, in the market for specialty beers, success is far more dependent on a carefully crafted, high-quality, highly flavoured product, local mystique and localised distribution that emphasises authenticity and careful handling.

Stages in Segmentation Analysis

Segmentation analysis proceeds in five principal stages. Let's look at this in the context of a number of examples.

1. Identify Key Segmentation Variables

The first stage of segmentation analysis is to determine the basis of segmentation. Segment decisions essentially are choices about products and customers, hence segmentation variables relate to the characteristics of the product or characteristics of customers.

The most appropriate segmentation variables are those that distinctly partition a market in terms of substitutability among customers. Market segments tend to be recognisable from price differentials.

A good example of price-based segmentation is seen in the form of General Motors during the 1920s. In contrast to Henry Ford's single-model strategy, GM identified six market segments ranging from the lowest price category, $450-$600, to the highest, $2,500-$3,500. Each of GM's divisions targeted a separate price segment, with Chevrolet at the bottom and Cadillac at the top.

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The Basis of Segmentation

Characteristics of Buyers

- **Industrial, size, technical sophistication, OEM replacement**
- **Household , benefits, lifestyle, demographics**
- **Channels, size, exclusive, general, specialist**
- **Geographical location**

Characteristics of products

- **Physical size,**
- **Physical size**
- **Price level**
- **Product features**
- **Technology design**
- **Inputs used (e.g., raw materials) Performance characteristics**
- **Pre-sales and post-sales services**

Typically, there are many customer and product characteristics that can be used as a basis for segmentation. In order for a segmentation analysis to be manageable, we need to reduce these to two or three. This requires that we do the following:

1. Identify the variables that are most are the most strategically relevant in creating meaningful divisions in a market. In metal containers, location is critical (cans are expensive to transport long distances), as is raw material.
2. Combine segmentation variables that are closely correlated. In the case of restaurants, possible segmentation variables such as price level, service (waiter service/self-service), cuisine (fast -food/full meals), and alcohol license wine served/soft drinks only) could be combined into a single variable, restaurant type, with three categories: full-service restaurants, cafes, and fast-food outlets.

2. Identify Key Segments

Once the segmentation variables have been established, individual segments may be identified by buyer type (industry, household, channel or region) and product.

Segmentation by Product Type and Region

	Europe	North America	Latin America	Australia	China	Africa
Luxury						
Full saloons						
Small saloons						
4 x 4						
Sports						

Thus a car manufacturer might segment by vehicle type (product) and geographical region (buyer type).

And the European metal container industry might be analysed by industry and product type.

Segmentation
by Product Type and Industry Sector

	Food	Fruit Juice	Pet food	Soft drinks	Oil	Beer
Aluminium						
Steel						
General						
Aerosol						

Further variables might be added, including regional, channel and benefits required.

Segmentation analysis can also be useful in identifying unexploited opportunities in an industry or market. For example segmentation of the restaurant business in a town or region might reveal a number of empty segments. The intriguing question to answer is whether such empty segments represent unexploited opportunities or whether they reflect a lack of customer demand.

Take the market for kitchen appliances. In the early 1960s, microwave ovens and dishwashers were manufactured almost exclusively for the catering trade. Segmentation analysis of the appliance industry might have alerted players established in these segments to opportunities for developing these products for the consumer market.

3. Assess Segment Attractiveness

Profitability within an industry segment maybe determined by Porter's Five Force Analysis. But it is important to note some important features regarding competition.

First, when analysing the pressure of indirect competition or substitute products, it is important to be aware of substitutes from other industries together with substitutes from other segments within the same industry. For example if one company, in the care industry plans to introduce a new 4 x 4 researchers might wish to consider competition from people-carriers.

Second, should a people-carrier competitor wish to enter the 4x4 segment with a 4x4 of its own, in other words, a producer from another segment within the same industry any decision to enter depends on whether there are barriers that restrict entry of firms from other segments. Such

barriers are called *barriers to mobility.* They are different from those barriers that offer protection from companies outside the industry.

Barriers to mobility are key factors in determining the ability of a segment to offer superior returns to those available elsewhere in the industry. Unless there are significant barriers to the mobility of firms other segments, a segment will be unable to maintain superior profitability to that of the industry. The increased flexibility of design and production made possible by computer-aided design and flexible manufacturing systems has had the effect of reducing barriers to mobility.

In the car industry, high-margin segments such as luxury cars, people-carriers and sports cars have seen a sharp rise in competition as volume car manufacturers have entered them.

4. Identify a Segment's Key Success Factors

Differences in competitive structure and in customer preferences between segments imply differences in the basis of competitive advantage. Taking buyers' purchase criteria we can identify the key success factors for individual segments.

For example, the UK retail food industry can be segmented on the basis of the age group of the customer (infants, children, youths, and adults), price, branding, and range. Combining and categorising these segmentation variables results in three major segments, each with different key success factors. All as shown below.

Segment	Key success Factor
• Low price, products sold under the retailers own brand with little ambience	• Low costs through global sourcing and • Little demand for packaging
• Medium priced products sold under the makers' (and retailers') brand and distributed through volume retailers	• Cost efficiency through large scale operations • Reputation for quality through effective marketing to consumers
• High priced products for 'gourmet' enthusiasts	• Quality of products, ingredients and creativity in design • Reputation through effective brand management • Strong consumer loyalty

5. Select Segment Scope

A final issue relating to the choice of segments to enter concerns the relative advantages of segment specialisation versus segment diversity. In other words the advantages of operating with a broad over a narrow segment focus depend on two main factors; similarity of key success factors and the presence of shared costs.

In an industry where key success –factors are similar across segments, a business can adopt a similar strategic approach in relation to different segments. If different strategies need to be adopted for different segments, not only does this pose organisational difficulties for the company, but also the credibility of the firm in one segment may be adversely affected by its strategy in another.

During 1999-2000, Mercedes' introduction of its A-class compact car was a failure, not only because Mercedes could not compete with the Japanese in this segment, but also because of the damage to the firm's reputation in the larger saloon segment.

Shared costs mean that broad-segment suppliers can achieve lower costs than their more focused competitors. The vulnerability of narrow segmentation to broad-line competitors is constantly being revealed, as the following examples suggest

The Vulnerability of Single Segment Players

In soft drinks, Seven Up's reliance on a single lemon-lime drink made it vulnerable to competition from broad-line competitors such as Coca-Cola and Pepsi. Ultimately, 7Up was acquired by Cadbury Schweppes.

The acquisition of specialist car makers Saab, Lancia, Jaguar, AMC-Jeep, Maserati, Audi, Alfa-Romeo, and Rolls-Royce by broad-segment car makers was a result of the inability of these specialists to spread their development costs over a large enough sales volume.

The relative merits of focused and broad-segment strategies vary among industries. 'The critical issue concerns the benefits of specialisation versus those of sharing joint costs.

Best wishes,

Andrew Pearson
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