

When & Why Segmentation Fails (And What To Do About It)



SEGMENTATION WHITE PAPER

It Seemed Like Such A Good Idea...

Marketing segmentation has been hailed as true “game changer.” A tactic that allows organizations to become more efficient with their expenditures and more effective with their strategies. Great in concept. Not so great in application, it seems.

Companies around the globe – both big and small – are the not-so-proud owners of hefty three ring binders and very persuasive PowerPoint documents that collect symbolic, if not real dust. The only thing these segmentation schemes have delivered without fail is a substantial bill. Sometimes followed by a job change in the chief marketer’s office.

I don’t mean to imply that all segmentation schemes fail. Indeed, some companies have done quite well in this arena. What I am saying, however, is that the failure rate is much higher than one would expect from a strategy that makes so much sense (conceptually).

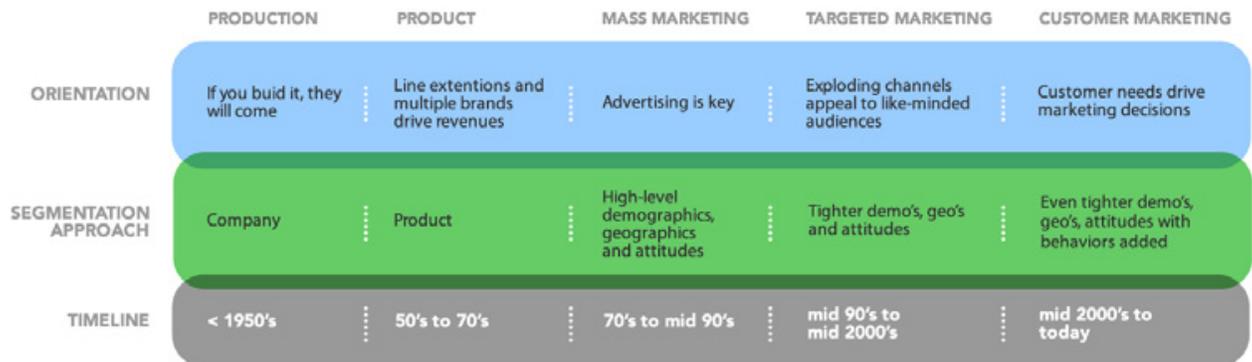
The question is *why*? It’s certainly hard to argue with the core premise – taking a mass of seemingly undifferentiated customers and/or prospects and segmenting them into groups that are alike within, but quite different between. The theory goes that by doing this, one can achieve tighter focus for the company and achieve marketing gains by being more relevant – delivering tailored marketing, service, product, channel and other tactics to each segment.

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Historical Perspective

It’s instructive to start this discussion with a review of the evolution of marketing – and marketing segmentation.

The following chart provides a roadmap for the journey from the “production orientation” to the “customer orientation:”



This view shows the varying means of segmentation – from segmenting by company and product up to the current state where segmentation focuses much more on customer attributes. The increased level of data available to marketers has allowed for segmentation on behaviors versus attributes obtained by market research or geography.

The point is, segmentation has evolved steadily from “one segment towards a segment of one.” (A key point that I will be revisiting.)

What Are We Trying To Accomplish?

When trying to understand the performance of a specific tactic – especially one that doesn’t seem to be working so well – a good place to start is with the objective. (While I will not be mistaken for Einstein, I am certain that a number of people ignore this concept.)

Let’s start with a definition for marketing. At a high level, mine has two parts:

1. Understanding what customers want and when they want it
2. Addressing that “want” with a relevant and differentiated solution

Simple enough. Now, what about segmentation? How does this help facilitate marketing?

1. By placing customers and/or prospects into groups that are similar within and dissimilar between...
2. We can identify what smaller groups of customer want and when they want it...
3. Which allows us to provide more relevant and differentiated solutions...
4. Resulting in more efficient and effective marketing.

This concept is so seductive that some organizations have embraced this as the way to drive their entire business process. The “customer focus” mantra of the mid 90’s to early 2000’s spurred many companies to implement large scale segmentation initiatives – some to the point of establishing customer segment management. Segment teams were established to focus on groups like Baby Boomers, Generation X & Y, Affluent, Mature, Early Stage Adopters, on and on.

The customer segment approach resulted in teams to address each customer segment across the entire organization’s offerings. This often led to mass chaos. Who owned the marketing budget – segment, product or marketing managers? Program implementation was very difficult due to the fact that each group [segment vs. product vs. marketing] had their own set of goals – many of which were more contradictory than complementary.

- Segment managers want to grow loyalty and profitability within their specific segment
- Product managers are tasked with achieving product-based goals
- Marketing managers are tasked with allocating the marketing budget to get the highest return

This is just one view of how segmentation programs failed to accomplish their original objectives.

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Segmentation Varieties

Segmentation approaches come in many different varieties.

Rob Jackson and Paul Wang, in their book *Strategic Database Marketing* (NTC Business Books, 1994), identified the following segmentation options:

1. Demographic
2. Behavioral
3. Psychographic
4. Geographic
5. Offer
6. Benefit
7. Product
8. Product usage
9. Purchase

I'm sure you can even think of more ways to segment. While there are many alternatives, I find that there are five major options I run into most often:

1. **Demographic** – uses demographic variables such as age, income, gender and education or “firmagraphic” information for businesses, such as years in business, sales size, employee size and SIC code.
2. **Behavioral** – uses behavioral attributes such as transactions (e.g., products purchased, amount spent or frequency of use), tenure, customer service calls and website behavior. RFM (Recency, Frequency, Monetary) schemes are a common behavioral approach.
3. **Value** – this approach typically focuses on current value and future value (or lifetime value) for each customer.
4. **Attitudinal** – focuses on how customers perceive the world and why they feel and behave the way they do.
5. **Combination** – attempts to combine data points used with the previous four segmentation schemes.

Each one seems to make sense. So again, why isn't segmentation a slam dunk? I offer three main reasons.

The Fateful 3

After being involved with, and learning of, segmentation programs gone awry, I conclude that there are three main issues:

1. **Business Issues**
 - a. Lack of understanding for how segmentation helps the company meet its specific goals. And often, no tangible, measurable goals in the first place. These items need to be thoroughly vetted before deciding to move forward with segmentation.
 - i. What business applications will the segmentation scheme influence/support/drive: marketing, customer service, pricing, channel management?

Each one [segmentation approach] seems to make sense. So again, why isn't segmentation a slam dunk?

- ii. How will we know if the scheme is working? For example, were you able to increase customer profitability in priority segments? Or, were you able to migrate customers to more profitable segments?
- iii. Crystallize what we intend to “solve” by implementing this scheme. Examples include improving the overall ROI for marketing or aligning sales, marketing and customer service to focus on the most important customer groups.
- b. Lack of institutional alignment, support and discipline.
 - i. How will the segmentation scheme come to life? Once the segmentation scheme is determined, how will the company implement – within and between functional areas?
 - ii. If the scheme is intended to drive multiple decisions, how is the organization aligned to deliver? For example, if the plan is to prioritize certain segments and focus company resources (across the board) on these segments, how will the company align to drive decision-making?
 - iii. Is there adequate communication, support and training to integrate the scheme into the company’s DNA?
 - iv. Will the company show the necessary discipline to adhere to the approach for the long term?

Within each segment, customers can still be quite different. This often results in imprecise targeting for specific tactics like product offers, messaging, and media channels.

2. Implementation Issues

- a. Is the scheme so complex that people can barely understand it let alone implement it?
- b. Is the scheme so simple that no one sees value in it?
- c. Is the scheme impossible to accurately implement? (A common problem for attitudinal schemes where customer assignment is extremely difficult. How can we understand the attitudes of every customer?)

3. Performance Issues

- a. The infamous “cure-all” perception problem.
 - i. For various reasons, some companies come to see segmentation as the panacea for all ills. Failure is almost certain when this happens.
 - ii. No, segmentation will not tell you what new products to develop; nor will it tell you why certain customers lapse; nor will it tell you why some customers won’t buy additional product. Turns out employees will still have to do their jobs and make decisions even after segmentation arrives.
- b. Segmentation only gets you half the way there.
 - i. Within each segment, customers can still be quite different. This often results in imprecise targeting for specific tactics like product offers, messaging, and media channels. Example:
 - 1. Three neighbors are in the same demographic segment: high affluent and middle age. One is blue collar with a high school diploma and owns four auto garages in town. One is college educated and is quite frugal, saving money at every chance. The third is a third generation millionaire, inheriting a boatload from deceased parents and spends money liberally. Each may look the same in a demographic scheme but are quite different in every other aspect.
 - 2. So, marketing to these three customers based on the segment profile will be less effective than one might guess.

What To Do?!

I suggest that there are three things for you to consider so that you do not fall into the segmentation death trap:

1. Hire someone that has been through this several times (an employee and/or a consultant)
2. Establish a “checklist” that vets the segmentation program before moving forward
3. Consider an alternative approach to classic segmentation

No. 1 is pretty straight-forward. By hiring an employee or consultant/partner that has been through this you avoid the pitfalls that lie waiting for you.

The checklist idea is a terrific way to: 1) identify potential problems before they happen, 2) get key player’s skin in the game by including them in the process (this will pay-off during implementation), and 3) keep you “clean” in case something breaks down after implementation (“hey, we went through the due diligence beforehand and all agreed”).

Following is the start of such a checklist – something you will need to custom fit to your needs:

SEGMENTATION TYPE:					
	Demographic	Behavioral	Value	Attitudinal	Combination
SEGMENTATION TECHNIQUE:					
	Research, Database Analysis & Secondary Sources	Database Analysis Supplemented By Research	Database Analysis, Supplemented By Research & Secondary Data	Research	Research, Database Analysis & Secondary Data
BUSINESS/MARKETING APPLICATIONS:					
Brand Positioning	Ok	Poor	Poor	Good	Good
Market Segmentation/ Analysis	Good	Poor	Poor	Good	Good
Market Message Strategies	Ok	Poor	Poor	Good	Good
Prospect Segment “Assignability”	Good	Poor	Poor	Good	Poor
Prospecting/Customer Acquisition	Good	Poor	Poor	Poor	Poor
Customer Segment “Assignability”	Good	Good	Good	Poor	Poor
Customer Cross-Sell	Poor	Good	Ok	Poor	Poor
Customer Retention	Poor	Good	Good	Poor	Poor
Customer Migration	Poor	Good	Good	Poor	Poor

I feel a bit more explanation is required for the Combination segmentation approach. This approach combines attitudinal data with other data, such as behavioral, in an attempt to provide a more holistic view. Operationally, these schemes require a short survey (3-6 questions) be administered to anyone requiring classification. You can imagine how difficult that is to implement. Therefore, the ratings I've supplied mirror those of the Attitudinal approach which also leverages primary research.

Finally, there is a new, alternative approach to classic segmentation. An approach that I believe is superior in many cases to the core segmentation concept of grouping customers. One caveat – it is useful only to those that have customer transaction data available.

If you are able to capture individual customer transactions, you no longer need to subject yourselves to the vagaries and pitfalls of traditional segmentation approaches.

Moving From One Segment, Beyond A Number Of Segments, To A Segment Of One

Technology allows us to manage customer relationships like never before. If you are able to capture individual customer transactions, you no longer need to subject yourselves to the vagaries and pitfalls of traditional segmentation approaches. You are free to market to a segment of one.

Let me start by circling back to marketing's ultimate goal:

1. Understanding what customers want and when they want it
2. Addressing that "want" with a relevant and differentiated solution

I call this segmentation alternative "Customer Management Optimization (CMO)." While it is not "optimization" in the strictest sense (calm down, operations research analysts) the concept centers on optimizing the effectiveness of customer contacts – one customer at a time.

I believe that the CMO concept is a worthy alternative to traditional segmentation. In fact, given its focus on individuals (vs. groups) it provides a more personalized marketing approach.

By definition, CMO is applicable to customer marketing – not prospect marketing. Keep this in mind as you evaluate its worth.

CMO Concept

CMO is built on the following foundation:

- Creating a customer marketing framework by:
 - Classifying customers by current value and future value
 - Determining the life stage of each customer
- Creating customer management goals for each cell in the framework as depicted on the right.

		LIFE STAGE					
		NEW		ACTIVE			INACTIVE
FUTURE VALUE	HIGH	N1 Aggressive Onboarding	7 Selective Grow	4 Retain/ Aggressive Grow	1 Aggressive Retain/ Aggressive Grow	I1 Reactivate	
	MEDIUM	N2 Onboard	8 Selective Grow	5 Retain/ Grow	2 Aggressive Retain/ Grow	I2 Selective Reactivate	
	LOW	N3 Natural Course	9 Natural Course	6 Retain/ Selective Grow	3 Aggressive Retain/ Grow	I3 Natural Course	
		CURRENT VALUE					

- TOP PRIORITY, MOST AGGRESSIVE MARKETING APPROACH
- MID-LEVEL PRIORITY AND MID-LEVEL AGGRESSIVENESS
- LOW PRIORITY AND LEAST AGGRESSIVE APPROACH

- Creating marketing tactics at the individual customer level that foot to customer management goals
 - Contact cadence based on customer management goals and individual buying patterns
 - » For example, “Aggressive Grow” customers receive the most aggressive contact frequency
 - On-boarding communications
 - Cross-sell & up-sell triggers
 - Lapse / repurchase triggers
 - Loyalty communications
 - Predictive model driven promotional mailings

Consider moving beyond traditional segmentation into the realm of true 1:1 communication. This is possible for businesses that track customer transaction behavior.

Once the strategy is defined, an automated, triggered-marketing system will need to be deployed to manage the marketing program. This will ensure that communications are delivered as prescribed in the CMO approach.

There are a number of potential triggered-marketing products available on the market today, including Metrics Marketing’s ATOMSM solution. ATOM (Automated, Triggered-Opportunity Marketing) is a turn-key solution that delivers the most relevant message – at just the right time – for each customer based on their unique needs. To learn more, go to www.metricsmarketing.com.

Summary

Traditional segmentation programs are fraught with potential potholes. Look before you leap by creating a checklist comparing segmentation approaches with business applications. Make sure the organization knows what it’s getting into.

Consider moving beyond traditional segmentation into the realm of true 1:1 communication. This is possible for businesses that track customer transaction behavior. As described above, Customer Management Optimization holds great promise for moving beyond simple segmentation.

About the Author

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