Market Segmentation

Dr. Paul Ammann

Head International Projects

Bern University of Applied Sciences

https://www.linkedin.com/in/paul-ammann/

Study Goals

On completion of this text, you will have learned...

... how to build customer & market segments

... how to select profitable segments

... how to differentiate your offering in the selected segments

Introduction

Segmentation is fundamental to develop a consistent market strategy – often called "the Queen of Strategy". Main benefits from market segmentation are

- An improved understanding of customers to maximize company strengths and optimize resources in core markets
- A strongly business focused approach of all involved employees by identifying and analyzing customer segments
- Opportunities for profitable growth through definition of target segments
- Improved margins through the development of target segment strategies
- Focused customer value proposition
- A pricing strategy consistent with the price sensitivity of different segments

Market Segmentation involves the following three steps:

1. Customer Segmentation: Identification of (sub-groups of) customers who share common needs or preferences driving their purchase decisions.
2. Selection of segments: Selection of which of these groups or segments to target. The selection is done based on a quantitative/financial analysis and a strategic analysis defining the market attractiveness of a segment and the ability to win of the company in the segment.
3. Marketing to selected segments: Presentation of well-defined sales & marketing initiatives to these targeted customers, emphasizing a distinctive product image or brand positioning.

In the following case, a supplier of routers categorized customers into four segments and correlated them with the supplied products. In the next step, the segments were analyzed with respect to their attractiveness. The segment network routers for insurance companies was selected for further development. Both quantitative and strategic analysis ended in positive results. The market is growing in the next five years and it is realistic that the company can keep a substantial part of the market. The attractiveness of the market, based on the analysis of key factors as market size and growth is high as well as the ability to win of the company, analyzed based on factors as product positioning, quality,… . In the third step, the differentiation and the marketing mix for this specific segment will be defined.

1. Define market segment
- Build Customer Segments
- Map to Product Mix

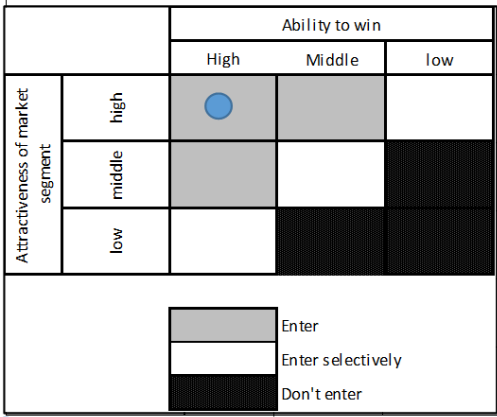
Product mix	Industry	Banking	Insurance	Public customers	Total market
	Segments total market revenue				
Branch Routers	100	200	100	200	600
Network Routers	300	100	200	200	800
Wireless Router	50	50	50	50	200
Total	450	350	350	450	1600

2. Select & target attractive market segments

Analyse segments:
- Strategic attractiveness
- Financial attractiveness

Analysis Network Routers to Insurance Customers

Strategic analysis



Financial analysis

	Year 1	Year 5
Total Market Revenue	200	700
Potential revenue of the company	50	150
Potential market share	25%	21%
Total Costs	40	100
Gross Margin	20%	33%

3. Marketing to selected market segments
- Define way to market for selected segments

	Marketing to Insurance Customers
Define Differentation and Positioning	Differentation based on Customer needs, competitors know-how and the know-how of the company
Product	Define augmented product based on positioning chosen
Price	Define pricing based on product definition & positiong
Place	Define and select channel system & partnerns
Promotion	Define promotion tools to be used / communication plan to be implemented

Figure 1 The process of market segmentation

The definition of a **market segment** is thus: A market segment is a group of customers with the most similar needs with respect to a product offered by the company. A market segment must be measurable and promise sufficiently high market potential to justify further development. Because of the similar needs of customers in the market segments, these can be efficiently addressed with coordinated marketing programs.

Market segment: Matching of customer segments to offered products

“Although the benefits of segmentation are now widely acknowledged, these must be weighed against the resource implications associated with implementing segmentation in practice” (Dibb, Simkin, 2009, S. 376). The goal of market segmentation is to create **groups of customers** with homogenous needs in order to address them with a marketing mix tailored to these specific needs. This allows the available resources to be used as profitably as possible. This is easier said than done. It can be very costly to collect attractive segmentation criteria, such as the benefit for the customer, and to implement them for market development. In addition, if a company sells to companies, it is often difficult to estimate which decision-makers can assert their needs. Moreover, the stability of these segments which can often only be determined at high costs is far from being ensured. When deciding for or against a segmentation criterion, its applicability in the company is an important decision-making factor. Market segmentation is also an iterative process - interesting segmentation approaches may be discarded when analyzing the costs for their implementation and new approaches for segmentation must be found.

Customer Segment: Grouping customer based on similar buying criteria

1.1 Customer Segmentation

Successful customer segmentation divides customers into groups based only on those needs and factors that drive purchase decisions. Some companies put too much focus on which products customers use, and they do not delve sufficiently into the reasons behind the product usage. Needs and preferences, however, are the driving force behind product or service selection. There are three customer segmentation dimensions, the organizational characteristics, the behavioral characteristics and the benefits desired of a product.

The three major customer segmentation methods are:

- Demographic segmentation based on criteria like industry, size, etc.
- Behavioral segmentation based on criteria like purchasing or usage patterns
- Needs based segmentation driven by e.g. preferences for price versus service

These dimensions are substantiated by various factors, depending on whether a company develops Business to Consumer (B2C) or Business to Business (B2B) markets.

	Demographic characteristics	**Behavioral characteristics**	**Benefits desired from product**
B2C	Age, Sex, Race, Ethnicity, Income, Occupation, Family size, Religion, Education	Purchase frequency, Usage occasion, Loyalty, Price sensitivity	Product performance, Durability, Ease of Use
B2B	Location, Size (sales, employees), Industry group, Years in business, Creditworthiness	Quantity and frequency of purchase, Type of purchase (new, modified, repeat, straight repeat), Purchasing approach (buying & payment preferences), Usage behavior (rate of usage, end-use application)	Product performance, Durability, Economy, Ease of use, After-sales services provided

Table 1 Three major customer segmentation dimensions

Customer Segmentation Criteria: Demographical characteristics

For the time being, customer segments are formed on the basis of easy-to-determine elements, such as geographic location, turnover, size and industry of the customer. Due to secondary data research, customer segments can be collected relatively simply and cost-effectively. The starting point is the company's widespread approach to segmentation based on primary customer requirements. A segmentation according to geographic aspects, as a function of the size as well as the branch of the customer business is conceivable. Segmentation based on these criteria is usually possible as the data can be collected relatively cheaply.

Internal sources

- Database with addresses of current and potential customers

Public sources

- Statistics of the chambers of commerce and industry
- Statistics of foreign trade chambers
- Statistics of national and international bodies
- National and international industry divisions
- Statistics of industry associations
- Annual reports of competitors and customers

Commercial sources

- Address data providers like Schober (www.schober.de)
- Offers of newspaper publishers (e.g.: www.handelszeitung.ch)
- Database provider (www.dialog.com)
- Dun & Bradstreet (www.dnb.com)

Table 2 Sources supporting demographical customer segmentation

Address databases are used as a basis for the segmentation, as for example from the company Schober (www.schober.de). The addresses are selected online according to different criteria: Address lists as a function of the branch, the region, the company size (turnover, number of employees, ...), the company headquarters and the legal form can be obtained for analysis and for the market development. The heading "Contact persons" allows an address selection based on the level of the contacts (e.g. Managing Director or Head of Marketing).

Customer Segmentation Criteria: Behavioral Criteria

Interesting for an optimal market support can be, for example, the segmentation according to customers based on the criterion of purchase and re-purchase. New customers behave differently from existing customers and need different, often more extensive support than customers who have already purchased a product from a provider. Thus, a company of the computer sector categorizes into "existing customers" and those with competing products. Customers with competing products are treated differently than "existing" customers. The information basis for this customer segmentation is the customer list of the company and the interviewing of the customers by the sales force. Customers about to make a new purchase, be it a technology or a product of a provider, must, in many sectors, be looked after more personally, more extensively and over a longer period of time than customers who want to make a pure repurchase.

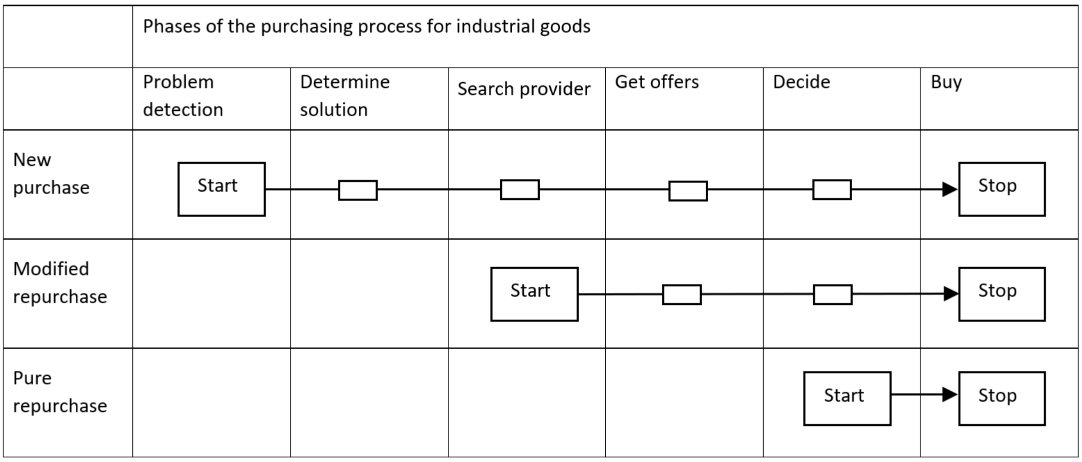


Figure 2 Segmentation based on type of purchase (new, modified,pure repurchase)

The after-sales services have gained significant importance for companies since higher margins can often be achieved in this business than in the business with new products. The low margins in the new product business are the result of the high competitive pressure in many markets. In order to gain maximum benefit from the after-sales business, the service has to be launched as an independent business - including its own market segmentation.

In the example below, a company has used the customer's behavior as a segmenting criterion, expressed in terms of the importance of service and the willingness to assign it to third parties. Depending on the customer's behavior, different service offers can then be created and offered to customers, from basic offers for on-call customers to very extensive service contracts for benefit optimizers.

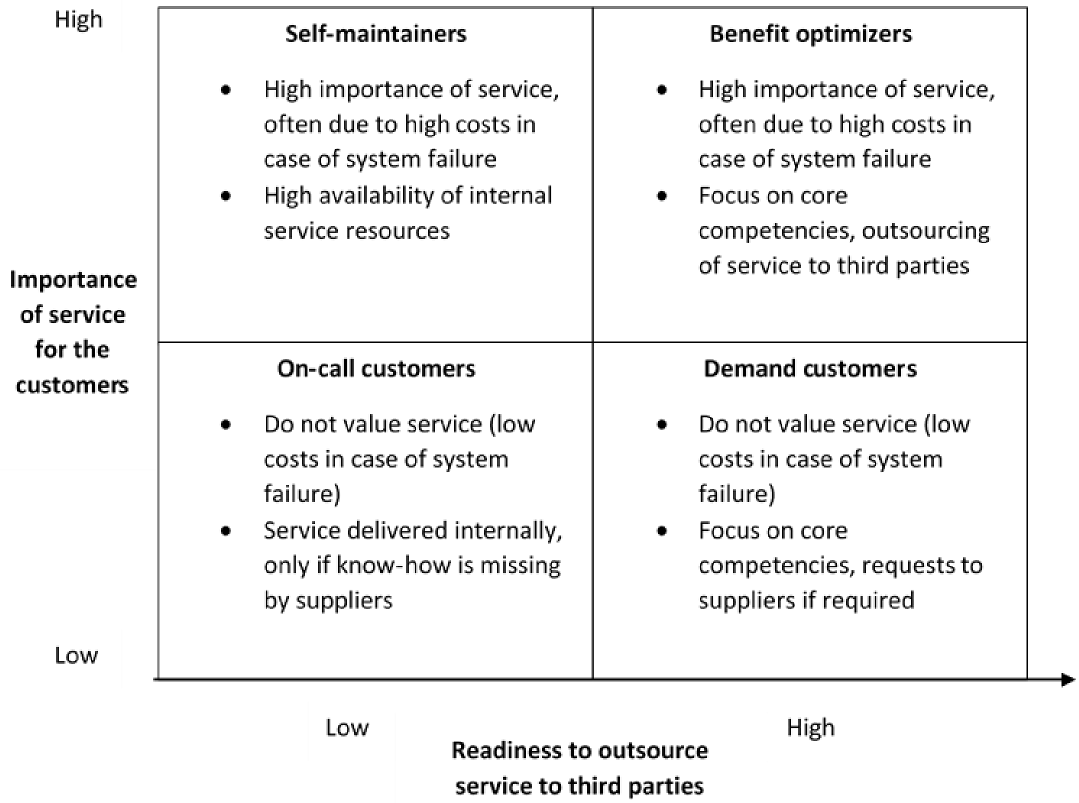


Figure 3 Case: A company segments customers as a function of their behavior in the service area

For "self-maintainers", services are important. Reasons for this are high-availability requirements and significant losses when a machine fails. However, the customers of this segment prefer to perform the necessary maintenance work themselves. They are convinced of the higher cost-effectiveness of an internal service provision. Or a high level of autonomy from the supplier is important to them, for reasons such as a remote location, because they must use proprietary procedures or to protect business secrets. Likewise, local laws, cultural factors and the influence of trade unions can lead to companies having to perform maintenance and repairs themselves. Nevertheless, this segment is significant for many suppliers. Often, they are unable to provide sufficient service know-how in all exporting countries, for example, due to cost-benefit considerations. The customers then assume the important task of the first-level support. The service provider must align its service contracts to this segment and cover the needs for information, support tools as well as training and know-how transfer. It is also necessary to use suitable e-business applications here.

"Benefit optimizers" buy the services largely from suppliers or third parties. Key features are the scarcity of own resources and know-how as well as difficulties in internally providing the high standard of service quality required by the drivers. The "benefit optimizers" focus on their core competencies and are interested in outsourcing the services to third parties. The provider's marketing communication directed to these customers must support the decision to resource sharing during maintenance. This includes the ability to provide services with the required response times and quality levels. This customer group clearly warrants special attention and sales efforts because it represents a potential main user of the service products. The scope of services of the machine builder can be so broad that it includes operator models in which the supplier takes over the entire maintenance or even the operation of the machines at the customer.

The "on-call" segment is mostly aimed at customers with a business that has low profit margins, low availability requirements, small losses in case of machine failure, etc., thus allowing only modest investments in the service. The most important point of contact with the service offered by the supplier is spare parts. These requirements are met by the smallest possible service product. The "demand customers" segment is characterized by similar characteristics: these customers often have a low profit margin and/or suffer little loss in the event of a failure of the machines. However, they show greater readiness to outsource services. If the service requirements rise, customers are increasingly interested in service contracts (for example regarding availability, response time, fixed tariffs for working hours, ...). By skillfully selling the service products, these customers can at best be inspired with offers from the "benefit optimizer" segment.

Customer Segmentation Criteria: Needs based Criteria, e.g. Price or Service

The ideal segmentation is based on the benefits expectations of the customer. In doing so, the benefit which the product provides to the customer or his end customer is placed in the foreground. In contrast to other segmentation criteria, the expected benefit is directly linked to the preference formation of requesters, and therefore plays an important role in the explanation and prognosis of demand behavior. The determination of segments at this level is carried out using the clustering method. With the help of surveys, the customer's preferences regarding the procurement of products are determined. Based on the results, the companies are combined into groups which use the same criteria in their decisions. Segmentation as a function of purchasing criteria for products in saturated markets is of significant importance. These markets are characterized by high competitive pressure, depressed prices and informed customers who buy products only if these meet their needs to a very large extent. In these markets, the big challenge is to avoid the commodity trap. "Commodity" refers to products that the customer classifies as equivalent to the offers of the competition. As a result, quality loses its importance as a distinguishing characteristic, the products are no longer examined in detail. Instead, price becomes the decisive distinguishing feature. In many industries, standardization efforts also hamper the development of competitive advantages due to distinct products.

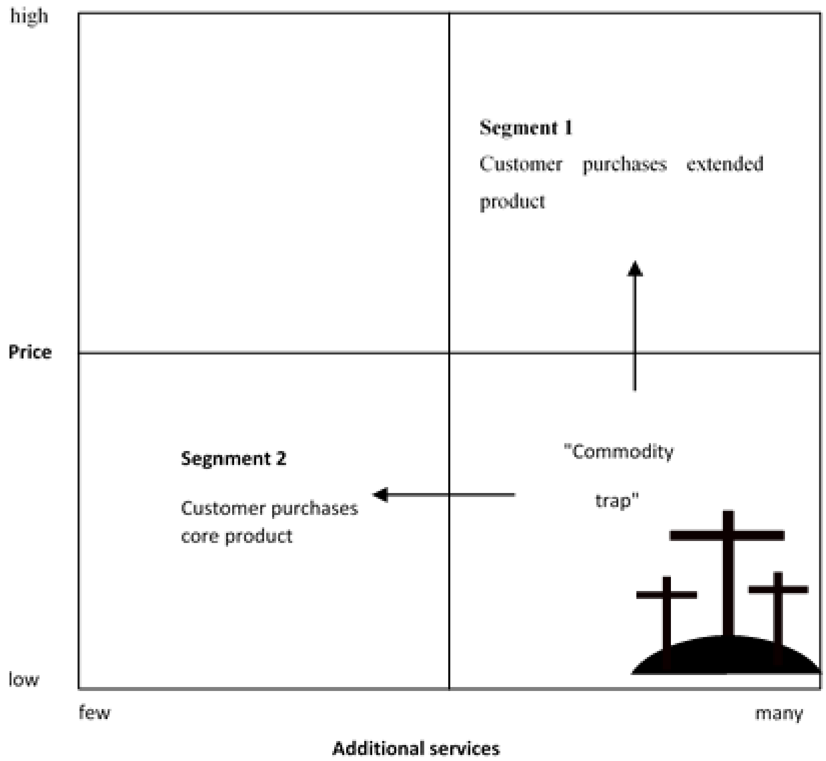


Figure 4 Customer segmentation based on product benefits

What is to be done if the competitive pressure and therefore the price pressure increases, the customer becomes more and more reluctant to pay for special services and classifies all suppliers of a certain product as equivalent? The commodity trap can be avoided by a clear market segmentation. Through surveys and observation of the market, the company receives the necessary information to divide its customers into at least two groups. Those that are really interested in an "extended product" and ready to pay for it, are offered a corresponding bundle of product and ancillary services (segment 1). For those who do not want to pay for additional services, a second offer is prepared without the desired Services (segment 2). But then the price is lower as well.

This strategy brings success to those companies which consistently separate the actual product/core service from the additional service. One example of this is the sale of personal computers via the Internet and by mail. Since many today understand the product personal computer and its application possibilities, fewer and fewer people are willing to pay for services. Sales via the internet accommodate those customers. The company which sells PCs in this way, however, must offer a very good after-sales service, such as hotlines, so that the customer does not feel left alone when he or she has any questions while using the personal computer.

The ideal segmentation according to customer benefits often generates a lot of effort for companies. The complete collection of the customer's benefits is performed using the conjoint analysis and is difficult and very complex. The conjoint analysis (German Verbundanalyse) serves the development of optimal products which are geared to the needs of the customers. Conjoint analysis reveals which combinations of properties a product must have in order to achieve the greatest customer benefit and thus trigger the greatest buying motivation. In connection with the target costing, the conjoint analysis supports the assessment of potential market prices. Often, it is already a challenge to determine whose benefits expectation should be captured as often several people are involved in product decisions, for example, in the family or in a company. Further, reachability of employees of customers for marketing measures is often not guaranteed. For this reason, many companies are using the pragmatic segmentation approach based on demographic characteristics, although the validity of these segments is limited. Segments due to demographic factors are characterized by high accessibility, but they only form a "random cut" with the segments based on customer expectations.

Decision for or against using specific segmentation criteria

The following possible segmentation criteria are analyzed to determine whether their use is worthwhile for the company.

The factor "relationship to purchasing behavior" captures how similar the designs of the purchasing process of the customers of a selected segment are. It is not certain whether the often-used segmentation criteria (industry, size, geographic location, ...) really generate groups of customers with similar purchasing behavior. However, due to the next two criteria - workability and measurability - it is often still useful to implement demographic segmentation.

Workability and measurability mean the possibility to address and measure the contact persons of a selected segmentation in an efficient manner. It can, for example, be very laborious to find the contact persons in the customer companies which exactly correspond to a selected segmentation.

Decision-making factors	Speaks **against** the choice of a Segmentation criteria	Speaks **for** the choice of a Segmentation criteria
Relationship to purchasing behavior	low	high
Workability	difficult	simple
Measurability	impossible	simple
Stability	low	high
Acceptance of sales	low	high

Table 3 Checklist: Decision for or against different segmentation criteria

The stability of the selected market segments is of crucial importance. The personnel and the allocation of the functions in companies change significantly in the medium term. A segmentation based on the functions of the buying center must be regularly updated by current address information.

Segmentation criteria	Change potential of the segmentation criteria
Industry	low
Company size	low
Product Requirements	high
Size of the buying center	rather low
Functions in the company	high, in the medium term
Information status	high
Information behavior	rather low
Internal change processes	high

Table 4 Change potential of the segmentation criteria

Acceptance with the sales force is of crucial importance in the definition of market segments since the personal sale usually plays a very important role in the communication mix of the manufacturers of these products. In addition, the sales force is one of the most productive sources of information on customer structures, needs, competitors and ongoing market changes and has the market information crucial for the design and selection of segments. It is therefore very important to integrate the sales force into the segmentation process.

The costs of differentiated market development depend on the level of differentiation with which a company wants to address different product / market segments. It is most laborious to develop and manufacture distinct products for different market segments. Less laborious is a differentiated approach with one identical core product and different additional services and prices. A distinction based solely on marketing communication is even more economical. The least effort is necessary to decide whether a particular market segment is to be developed. Only information costs are incurred here.

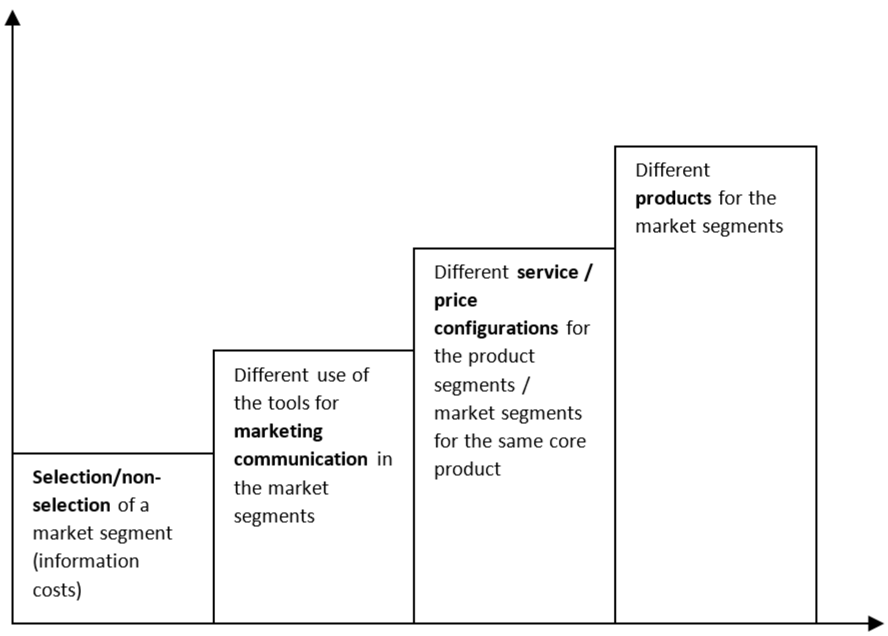


Figure 5 Costs of different development approaches

Market segments - mapping of offered products to targeted customer segments

Due to the selected segmentation criteria as well as the products manufactured by the company, the possible market segments are formed. These are then examined with respect to their strategic and financial attractiveness. This is discussed in the next section. In the example below, the company has chosen a geographical segmentation as well as a segmentation based on the industry's position in the market: distribution partners and customers. The possible market segments (in grey) are now examined to see whether their development is worthwhile.

		Products		
		Grinding machines	Milling machines	Manufacturing center
Customer segments (market)	*Domestic*			
	Distribution partners			
	Service partners			
	End customer			
	Textile machine			
	Food and packaging manufacturers			
	Pump manufacturer			
	Abroad			
	Distribution partners			
	Service partners			
	End customer			
	Textile machine			
	Food and packaging manufacturers			
	Pump manufacturer			

Market segments which can be selected for market development and must be further examined in terms of strategic and financial attractiveness

Figure 6 Market segment: Customer segments mapped to the products offered by the company

With many-dimensional customer segmentation and – in many companies – many products sold to those customer segments, the market segmentation can be become very complicated. Therefore, the potential market segments have to be analyzed based on their strategic and financial benefit for a company.

A market segment or a group of market segment should be chosen for further market development if

- The segment is attractively positioned in the “market attractiveness” / “ability to win” matrix

- It is large enough to promise an attractive contribution to the margins of the company

The next section deals with how these two criteria are analyzed.

Self-Check Questions

1. What are the three stages of market segmentation?

____

____

____

2. Are the following statements true or false?

The segmentation based on behavioral characteristics categorizes customers based on criteria such as quantity and frequency of purchase, type of purchase (new, modified, repeat), purchase approach

☐ True

☐ False

Market segmentation helps companies to avoid the commodity trap

☐ True

☐ False

Relationship to purchasing behavior, workability, measurability are three important criteria to decide whether customers should be segmented according to a particular segmentation criterion

☐ True

☐ False

3. Please complete the following sentence:

"Commodity" refers to products that the _______________________. As a result, features and quality____, the products are no longer examined in detail. Instead, _______________________ becomes the decisive distinguishing feature.

1.2 Selection of market segments for market entry

The implementation of the market segmentation in the company is associated with a great deal of effort since structures, processes, products, sales organization, etc. must be adapted. Not all theoretically possible market segments fulfill the economic basis to justify such an effort. Therefore, it is rarely useful to develop all possible market segments. The theoretically conceivable market segments according to the product/market matrix are therefore to be assessed on the basis of important factors. The market segments are selected based on the assessment. In principle, the goal is that the additional income gained through differentiated a market approach exceeds the required costs.

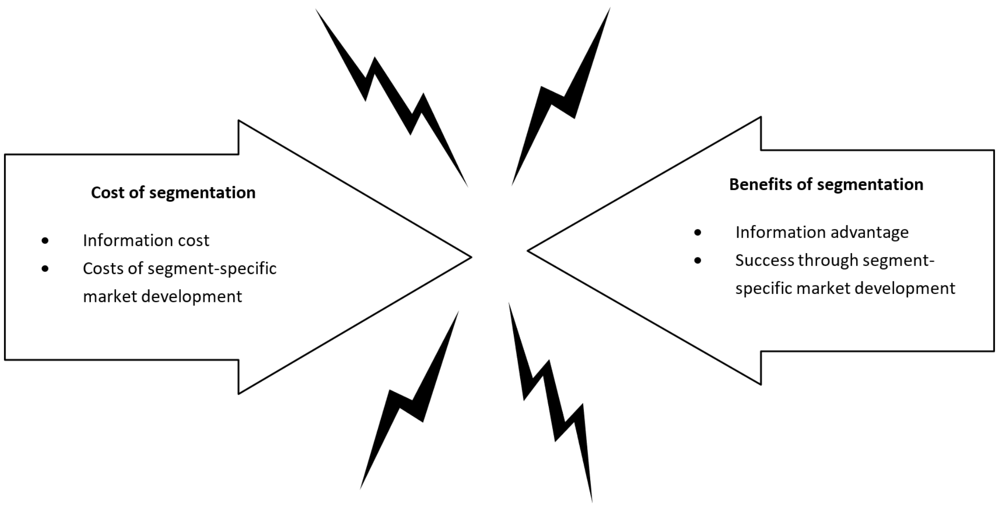


Figure 7 Cost/benefit considerations

The company must answer two questions: How high is the strategic attractiveness of potential market segments? Is the development of the market segments profitable?

Attractiveness of market segments - strategic assessment

Before the decision to develop new market segments, the five items in the next figure provide important indications for or against entry into this segment.

A market segment is the more attractive the smaller

- the rivalry of the competitors within the segment is
- the power of suppliers of important raw materials or individual parts for the manufactured product is
- the power of the customers that can influence the prices and other parts of the offer is
- the risk is that the offered product will be replaced by new offers
- the risk is that new competitors will enter the market segment

Figure 8 Strategic attractiveness of potential market segments

The risk of new competitors has re-emerged in many markets. It is important in today's very dynamic markets that not only direct competition is included in the analysis. It is more often the case that products are being challenged by offers that can satisfy the needs of customers in a completely new and innovative way. The suppliers of classical solutions can thus be quickly put under intense pressure. Examples of this are Uber in the taxi business, Airbnb in the hotel business and Netflix in the television business. Also, companies such as machine tool manufacturers are facing new, unexpected competitors. Abrasive and milling machine manufacturers have always been the providers for automotive suppliers who manufacture parts of the highest precision. Recently, an innovative technology could establish itself: sintering in which these parts are cast from metal powders and then consolidated by a kind of "baking process". Although this technology is today only profitable with very high unit numbers, the machine tool manufacturers have to adjust to the fact that they will be in competition with a very unexpected type of company, namely the chemical industry.

In the analysis of new market segments, therefore, potential suppliers of innovative technologies must also be included in the competition analysis in addition to traditional suppliers.

The market attractiveness / ability to win portfolio

The market attractiveness / ability to win portfolio is appropriate to assess the attractiveness of individual market segments as well as the strengths of the provider against the competitors active in it.

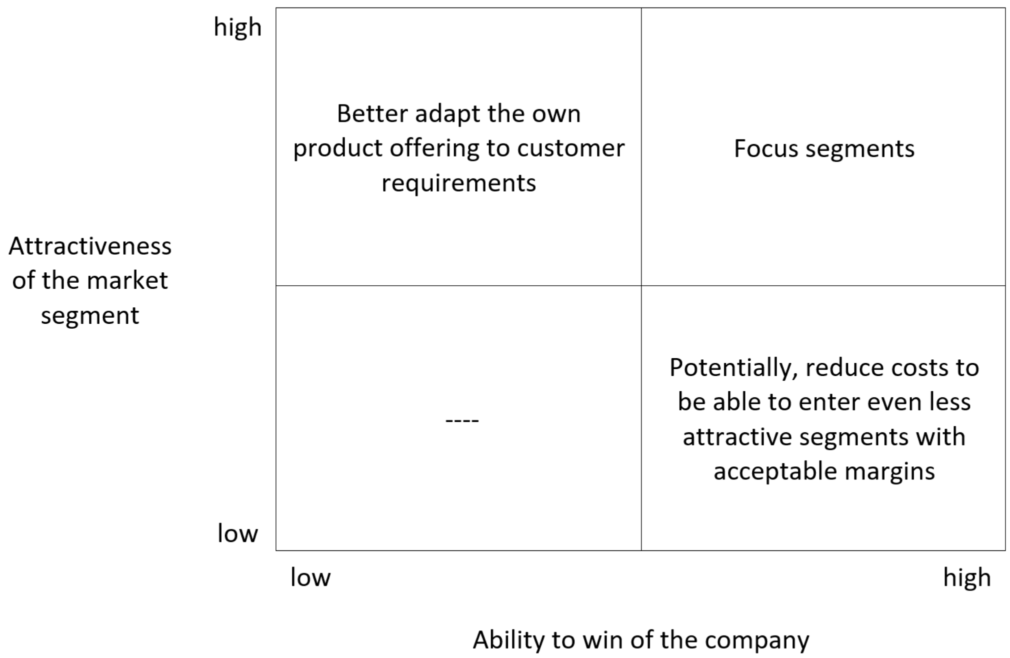


Figure 9 Focus on attractive segments in which the company has great chances

The following factors are often decisive for the attractiveness of a market segment: market size, market growth, risk of substitution products, competition intensity, supplier power, price situation, technical development, general economic and political development. However, the attractiveness of a market segment alone is not decisive for whether it should be developed by a provider. It is just as important to assess the strengths of the supplier in comparison to the competition in this market segment. The ability to win of a company is often assessed with the help of the factors such as product (quality, additional services ...), prices and conditions, marketing communication, sales and know-how (state of research and development)- all compared to the competition. The factors that should be used for the market attractiveness, as well as the analysis of competitive advantages, must be individually assembled and evaluated for each segmentation strategy.

With the help of the value benefit analysis method, the individual factors are weighted and evaluated. The weighting indicates how important the relevant analyzed factor is compared to the other factors. The valuation shows how positively or negatively a particular factor is assessed. The final value of a factor is the result of the multiplication of the weighting with the valuation.

Point evaluation procedures help to prepare the decision for or against the choice of a market segment for active development. However, scores based on weighting and valuation are always given on the basis of subjective assessments. The results of the point evaluation method must therefore be interpreted with the appropriate caution.

In the illustrated example, the manufacturer sees an interesting market and, in comparison with the competition, he is in a medium position regarding the "ability to win" criteria. Market segments which can be located in the fields at the top left of the portfolio promise a successful market development. Market segments in the fields on the lower right, on the other hand, are rather uninteresting. Prior to the final decision on the development of a market segment, additional cost/benefit considerations as well as the revenue and cost calculation are to be prepared. Based on the financial analysis, it can be interesting to enter the market segments positioned in the "enter selectively" fields, for example the company might be able to harvest revenue in a less attractive segments due to its strengths.

	Weighting	Evaluation	Value		Weighting	Evaluation	Value
Attractiveness of the market segment • Market size • Market growth • Substitution products • Competitive intensity • Supplier power • Price situation •	20 30 10 10 10 20	7 8 8 7 8 8	140 240 80 70 80 160	**Ability to win compared to the competition** • Products: (quality, additional services, ...) • Prices • Marketing Communication • Sales • Market position • Know-how •	20 20 10 20 10 20	9 4 9 2 5 8	180 80 90 40 50 160
Total	100		770		100		600

Weighting: indicates how important a factor is compared to the other factors (the sum of weighting is always 100)

Evaluation:
1: this factor is assessed very negatively
10: this factor is assessed very positively

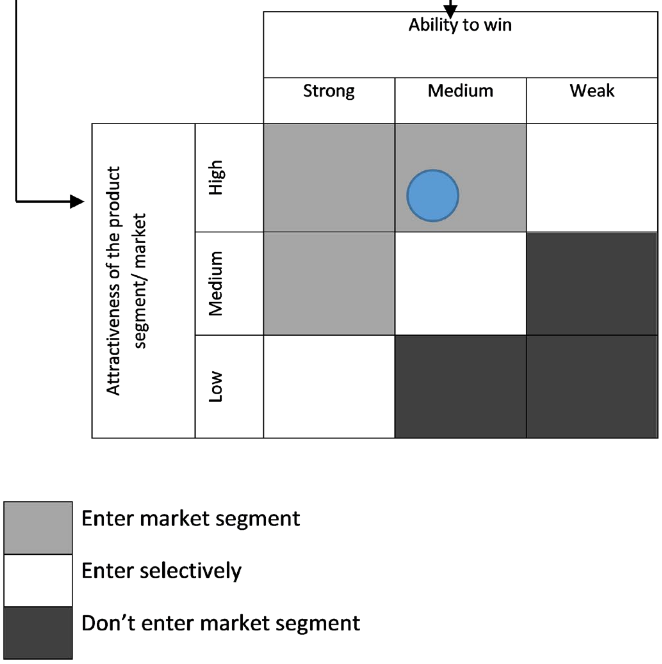


Figure 10 Market attractiveness/Ability to win matrix – McKinsey matrix

Attractiveness of market segments - financial assessment

In addition to the strategic assessment of the attractiveness of the segments, financial valuation is another important decision criterion for or against the development of possible market segments. In order to estimate the financial results, a revenue and cost calculation has to be made. This helps to estimate whether the development of a possible new market segment will be economically worthwhile. In the illustrated example, two new market segments are being discussed. The same product can be used for developing segment 2 as well as for the original market segment 1. No additional development costs are incurred in the development of this market segment. This case is conceivable when expanding the market development to a new geographic area with existing products. Market segment 3, on the other hand, is a segment for the development of which a new product must be created or the existing one must be fundamentally changed. This entails high development and communication costs. Although segment 2 is actually less attractive than Segment 3 because of the expected sales revenues, it is finally more economical to develop segment 2 because of the additional costs.

	Market segments		
	1	2	3
	Existing market segment	Possible new market segment	Possible new market segment
Sales (units)	30	10	20
Potential total sales	**9 000**	**3 000**	**6 000**
Costs:			
Cost of Information for analysis	40	40	40
Development	3 000		3 000
Production	3 000	1 000	2 000
Logistics and Storage	300	100	200
Training (sales force/distribution partner)	50	50	50
Marketing Communication	200	200	600
Order processing	90	30	60
Sales	900	300	600
Total costs	**7 580**	**1 720**	**6 550**
Potential Profit Contribution	**1 420**	**1 280**	**-550**

in 000 Euro

Table 5 Example of a revenue and cost calculation

Self-Check Questions

1. On the basis of which two factors are market segments examined in order to decide whether the development is worthwhile

____

____

____

2. Are the following statements true or false?

In addition to market attractiveness the company's ability to win is equally important in deciding whether or not to choose a enter a market segment

☐ True

☐ False

The segment financial planning is not important for the decision on the further development of market segments

☐ True

☐ False

New competitors can today interfere in traditional markets and have to be specifically identified and integrated into the analysis

☐ True

☐ False

3. What nine factors are often decisive for the attractiveness of a market segment?

____

____

____

1.3 Develop market segments - define way to market

After the selection of the most promising market segments has taken place, the appropriate differentiation strategy must be determined in a further step for the development of these segments. The company decides first about the differentiation of its product against the competition products and then determines the marketing mix which is to be used for the development of the respective market segments. The goal is to be able to offer the customer a distinctive benefit through the optimized use of various marketing instruments. The influence of segmentation on the company organization and on the distribution system is important.

Differentiation strategy for the selected segments

The chosen strategy of differentiation depends on three conditions. First, the chosen differentiation must correspond to customer needs. In addition, it is to be clarified where and how strong the competition has built up potential for differentiation. The determination of these two factors is based on the results of specific market research programs. Thirdly, the chosen differentiation must also be implemented by one's own employees. In most cases the question is whether the employees have the necessary know-how. This is particularly important today as differentiation is often to be realized at the level of services. The conditions that a possible competitive advantage must fulfill, so that its implementation is worthwhile, are:

- The competitive advantage is communicable and recognizable for the customer

- The competitive advantage brings an additional benefit to a sufficiently large number of customers
- The customers are willing to pay a higher price for the products or to buy a larger number of them because of the competitive advantage
- the competitors should not be able to copy the competitive advantage easily

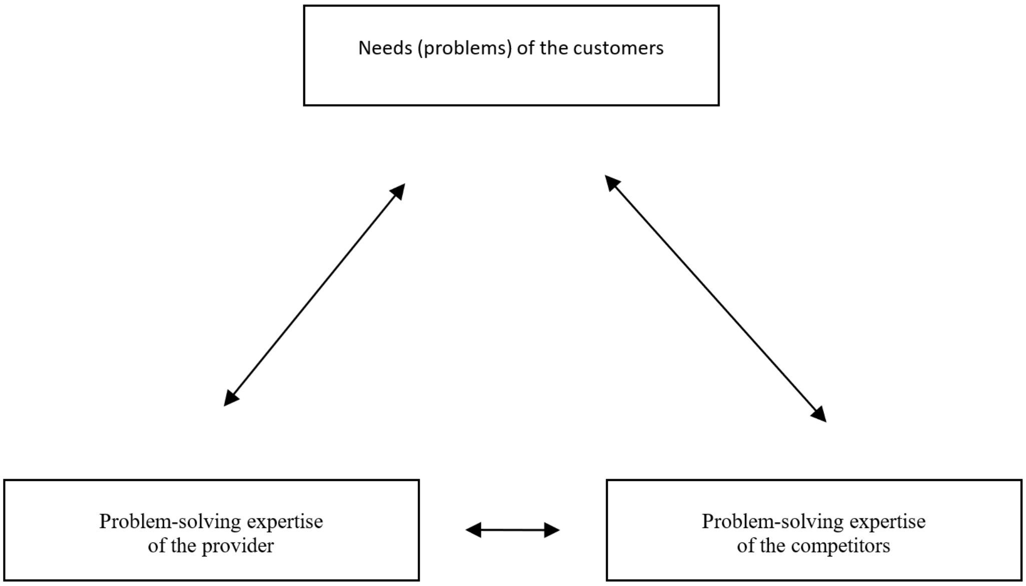


Figure 11 Determination of the differentiation strategy (Backhaus)

ABB Turbo Systems AG - for example - produces turbochargers for large diesel engines with 830 employees. These are mainly used in power plants and in large ships. The use of a turbocharger increases the power of a diesel engine by about 75 percent. The turbocharger accounts for about ten percent of the costs of an engine.

The main needs of the customer segment "Ship owner" is world wide service opportunities at the highest possible quality. The problem solving expertise of customers is more focused on producing new turbochargers.

The differentiation strategy of the company involves two points:

- Customer Proximity: the over 100 Service Stations in more than 50 countries, operating 24/7, are strategically located at major centers of operational and engine activities in all major ports in the world to ensure that the company is present, whenever and wherever the customers need service

Global uniformity: To ensure a uniform, rapid response to the needs of the customers and consistent standards of workmanship, all service staff is trained and qualified in-house at the Swiss Training Center and all service stations are equipped to the same high technical standards and using global installed base data.

Marketing and way to market

Based on the differentiation, the strategic analysis and the financial analysis, the company decides to use undifferentiated, concentrated or a differentiated market approach to cover the whole market, singular market segments or several different market segments.

One key decision in marketing is the way to market – the distribution management. It deals with the question of how the products and additional services find their way to the selected customer segments. The company has to decide which channels are used to cover the market segment in an optimal way. This is the topic of the next Chapter.

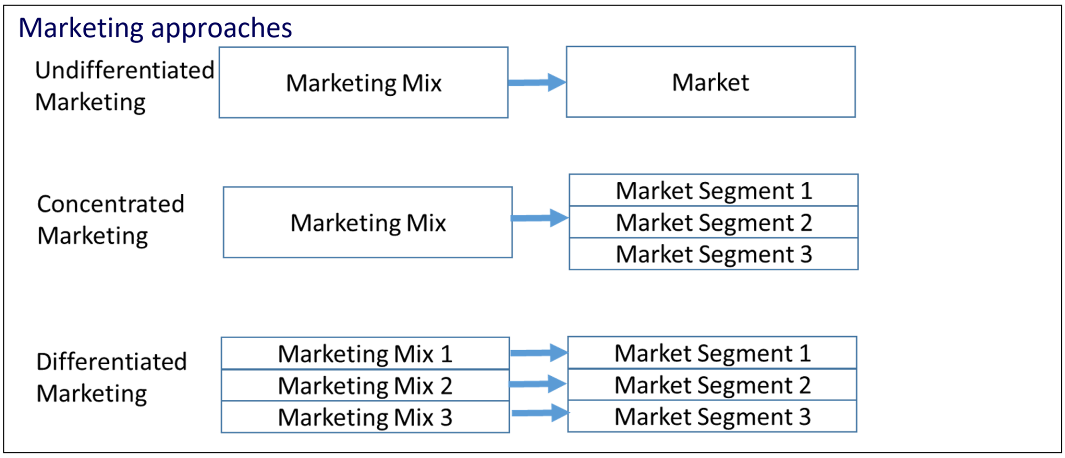


Figure 12 Marketing Approaches

The most important principles for segmentation can be summarized in seven "golden" rules.

Rule 1: The market segmentation is carried out in three steps: identify and form segments, select segments and develop segments.

Rule 2: Segmentation must be based on sound data. As a first step, segments are created at the level of organizational segments which are usually simple and cost-effective to create. If this segmentation is insufficient for promising market development, further criteria are used.

Rule 3: A segment is never just a particular group of customers. The definition of a market segment also includes the design of the product, the sales channels and the communication adapted to the identified customer requirements.

Rule 4: A market segment should only be selected for active development if the target market is attractive and the company can distinguish its offers from the competition in a way that is visible and significant for the customer.

Rule 5: The goal of every market segmentation is the optimal use of scarce marketing resources. Segmentation approaches which require more effort than promise likely benefits should not be implemented.

Rule 6: Segmentation is an iterative process. A customer segmentation that appears to be optimal can be unattractive in reality, if it involves highproduct development cost. Thusother segmentation approaches have to be evaluated.

Rule 7: The market segmentation must be checked regularly with regard to its relevance and effectiveness.

Self-Check Questions

1. Name the three factors to determine a competitive differentiation in a market segment

____

____

____

2. Are the following statements true or false?

Market segmentation is the basis to define the marketing approach in a segment.

☐ True

☐ False

Benefits and costs have to be analyzed carefully before implementing a differentiated marketing approach

☐ True

☐ False

3. Please complete the following sentences:

   A competitive advantage must fulfill the following conditions in order to be effective in the long term

   - The competitive advantage is _______________________and _______________________to the customer
   - The competitive advantage brings an _______________________to a _______________________ customers
   - The customers are willing to ____ because of the competitive advantage
   - The competitors should be able to _______________________.

The goal of every market segmentation is the optimal _______________________. Segmentation approaches which require more _______________________than likely _______________________should not be implemented.

Summary Market Segmentation

Summary

Market Segmentation involves three steps.

As a first step, customers are categorized into groups with the most similar needs to each other. The main advantage of this segmentation is that these customer groups can then be developed efficiently with similar marketing programs. The three important segmentation criteria are organizational criteria such as industry, number of employees, geographic location; the customer behavior, e.g. in the case of new or repeated purchase and the segmentation according to customer benefit.

In the second step of market segmentation - targeting - the segments that are attractive for further development are selected from the possible segments. This is done by determining the market attractiveness of a segment and determining the competitive advantages of a company in a segment. Other decision-making factors for or against the development of a segment are the addressability and stability.

In the third step of market segmentation, the differentiation and marketing programs targeted at the segments are planned and executed.

Appendix 1 - Literature

Backhaus, K. (1997), Industriegütermarketing, München: Vahlen

Dibb. S., Simkin L (2009). Implementation rules to bridge the theory/practice divide in market segmentation. Journal of Marketing Management 2009(25) 375 – 396.

Lombriser R., Abplanalp P A., (2015) Strategisches Management, Zürich: Versus

Appendix 2 – List of Tables and Figures

Customer segmentation based on product benefits	Source: Author.
Checklist: Decision for or against different segmentation dimensions	Source: Author.
Change potential of the segmentation criteria	Source: Author., based on Backhaus, 1997, p 195
Costs of different development approaches	Source: Author.
Market segment: Customer segments mapped to the products offered by the company	Source: Author.
Cost/benefit considerations	Source: Author.
Strategic attractiveness of potential market segments	Lombriser, 2015, p 105
Focus on attractive segments in which the company has great chances	Source: Author.
Market attractiveness/Ability to win matrix	Lombriser, 2015, p 213
Example of a revenue and cost calculation	Source: Author.
Determination of the differentiation strategy	Backhaus, 1997, p 23
Marketing approaches	Source: Author.

Appendix 3 - Solutions for Self-Check Questions

1.1 Customer Segmentation

1. What are the three stages of market segmentation?

Segment customers and form market segments

Select attractive segments

Marketing in the selected segments

2. Are the following statements true or false?

The segmentation based on behavioral characteristics categorizes customers based on criteria such as quantity and frequency of purchase, type of purchase (new, modified, repeat), purchase approach

☑ *True*

☐ *False*

Market segmentation helps companies to avoid the commodity trap

☑ *True*

☐ *False*

Relationship to purchasing behavior, workability, measurability are three important criteria to decide whether customers should be segmented according to a particular segmentation criterion

☑ *True*

☐ *False*

3. Please complete the following sentence:

"Commodity" refers to products that the customer classifies as equivalent to the offers of the competition. As a result, *features and quality lose their importance as a distinguishing characteristic*, the products are no longer examined in detail. Instead, *price* becomes the decisive distinguishing feature.

1.2 Selection of market segments

1. On the basis of which two factors are market segments examined in order to decide whether the development is worthwhile

- *Strategic attractiveness*
- *Quantitative / Financial attractiveness*

2. Are the following statements true or false?

In addition to market attractiveness the company's ability to win is equally important in deciding whether or not to choose a enter a market segment

☑ *True*

☐ *False*

The segment financial planning is not important for the decision on the further development of market segments

☐ True

☑ False X

New competitors can today interfere in traditional markets and have to be specifically identified and integrated into the analysis

☑ True X

☐ False

3. Please complete the following sentence:

The following nine factors are often decisive for the attractiveness of a market segment: *market size, market growth, risk of substitution products, competition intensity, supplier power, price situation, technical development, general economic and political development.*

1.3 Develop market segments

2. Name the three factors to determine a competitive differentiation in a market segment
   - *Customer needs*
   - *Problem solving competence of the competition*
   - *Problem solving competence of the company*

4. Are the following statements true or false?

Market segmentation is the basis to define the marketing approach in a segment.

☑ True

☐ False

Benefits and costs have to be analyzed carefully before implementing a differentiated marketing approach

☐ True

☑ False

5. Please complete the following sentences:

   A competitive advantage must fulfill the following conditions in order to be effective in the long term

   - The competitive advantage is *communicable* and *visible* to the customer

- The competitive advantage brings an *additional benefit* to a *sufficiently large number of* customers
- The customers are willing to *pay a higher price for the products or to buy a larger number of them* because of the competitive advantage
- The competitors should not be able to *copy the competitive advantage easily.*

The goal of every market segmentation is the optimal *use of scarce marketing resources*. Segmentation approaches which require more *effort* than likely ~~benefits~~ should not be implemented.