

# Teaching Market Segmentation: The Eight Step Process

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## Keywords

Segmentation  
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*Although market segmentation is one of the most important strategic management tools available for business managers, and has been part of the marketing/business curriculum for years, it is commonly taught from a theoretical perspective leaving students ill-prepared to tackle this challenge in the real world. This paper seeks to bridge the gap between segmentation as practiced by marketers and as commonly taught in the classroom. An eight step process that was developed, refined, and has been successfully implemented in multiple live case/consulting projects during the past ten years at the undergraduate, graduate, and executive education level is presented.*

## 1. Introduction

Years have passed since it was first recognized that different consumers transform needs into wants in different ways. Product differentiation responds to this lack of homogeneity in demand; segmentation disaggregates demand and recognizes “several demand schedules where only one was recognized before” (Smith 1956, p. 5). Market segmentation is considered to be one of the most important strategic management tools available for business managers (Dickson and Ginter 1987; Johnson 1971; Kamakura and Russell 1989), and has been part of the marketing and business curriculum for years. However, the way that marketing instructors have traditionally taught students how to segment a market is confusing and inefficient (Schibrowsky, Peltier, and Collins 1999). In the 1960’s Haley (1968) suggested that segmenting a market based on causal factors—benefits-sought approach—rather than descriptive factors would yield a better understanding of consumers and the market. The problem with this approach is that it is difficult to execute in a classroom and it seldom yields a consistent set of segments (Schibrowsky, Peltier, and Collins 1999). As a consequence, instructors commonly explain segmentation as splitting the market into groups of customers that share certain characteristics based on different kinds of variables—demographic, psychographic, socioeconomic, etc.—but do not explain how to perform the analysis. Students are thus left to figure out how to actually develop a segmentation strategy. This undermines the strategic importance of segmentation and prevents students from intuitively comprehending how is it that it can become one of the most powerful competitive advantages for a company.

Companies today are using profound consumer insights in order to segment their markets, so focusing on segmenting a market based on traditional variables (cf. Beane and Ennis 1987) limits the marketing curriculum and does not equip graduates with the necessary tools to be successful in their careers. Schibrowsky, Peltier, and Collins (1999) addressed this issue and developed an alternative experiential learning approach. Their work, however, is at least fifteen years old and has room for improvement. Its main weakness resides on the fact that the first step they propose focuses on the product and not the consumer, which can very well lead to confusion and a product orientation. Although new marketing textbooks address the need and

the power of focusing on benefit/behavioural segmentation or usage occasion, the few that provide an explanation (process) on how to perform it (Boone and Kurtz 2014; Grewal and Levy 2014; Perreault, Cannon, and McCarthy; Pride and Ferrell 2014) do not provide enough detail for the student to be truly prepared to segment a market, as the processes they describe are more conceptual than a true step-by-step process. This paper thus seeks to update the segmentation curriculum by providing support to the current business perspective on segmentation and a detailed Eight Step process that will guide any marketing student to better comprehend and develop a powerful segmentation strategy. This Eight Step process is the result of years of consulting, tutoring, and teaching and has been successfully implemented in over one hundred different live cases (student-led consulting projects). It is best understood with a hands-on approach, and thus it is recommended that the theory explanation is followed by an in-class case study to practice its implementation and, ideally, further practiced within a real or simulated strategic live-case marketing or business plan development project. The Eight Step process allows marketing and business educators to expose their students to benefit/behavioural segmentation, as well as to teach them how to develop a segmentation strategy from scratch.

## 2. The Eight-Step Process Explained

Traditional segmentation approaches commonly split the market based on static characteristics of the consumer while ignoring the individual's consumption dynamics; this means that the same individual might make different consumption decisions depending on different circumstances "within a single product market at the same point in time" (Sismeiro, Mizik, and Bucklin 2008, p. 64). For example, if a male college student were deciding what to cook for dinner, his decision would vary if he was cooking only for himself or for a date. While his cooking abilities might be limited to boiling pasta, he might decide to purchase dry pasta, tomato sauce, a can of tuna and frozen vegetables to eat by himself, while if preparing dinner for a date he might purchase fresh pasta and fresh vegetables in order to prepare a more experiential meal. The underlying difference between these two consumption decisions cannot be explained by any static variable. The consumer is the same, his income level is the same, and his demographic and geographic characteristics are the same. In other words, traditional segmentation variables would not allow us to predict that this particular consumer will behave any differently on any given night. But we all know that this does not make sense. As consumers we constantly make different decisions in what could be considered different situations. What varies then is his motivation. While in the first scenario his need is to satisfy his hunger, in the second scenario his need is to make a good impression on his date. In other words, the same individual will make a different consumption decision depending on the underlying sought benefit.

From a brand perspective, the approach should be the same. Let us consider Montblanc, the writing instrument. From a functional perspective, a Montblanc pen satisfies the need to write. But we all know that no one would buy a \$500 pen only to write when a 30 cent Bic pen can perform the same function. From a product category orientation both Bic and Montblanc are pen brands. But from a marketing/solution orientation, Montblanc and Bic are in different businesses. What need does Montblanc really solve? Many different answers can be given to this

question. For example, we could argue that Montblanc pens are mostly purchased as gifts while Bic pens are purchased as school or office supplies. What is a common graduation gift, a ten pack of Bic pens or a nice more expensive pen and pencil such as a Montblanc? So here is where the first strategic decision should be made. Based on its mission, a company must decide what business it is in. While Bic might be focused on the office and school supply business, it seems reasonable to think that Montblanc is in the gift business. The definition of a company's "business" is what is done in step 1 of the segmentation process.

### ***Step 1- Defining the reference market***

A reference market is defined by answering three questions: *what* functions/needs are being solved?; *who* is the consumer group we are seeking to satisfy?; and *how* can their needs be met? (Lambin 1997). The *what* of the reference market should always be defined in terms of a solution or a need, never in terms of a product. Defining the *what* in terms of a product would lead to a product oriented business. The *who* of the reference market refers to groups of clients that represent different businesses for the company. In general, it is possible to argue that the only potential groups of clients are consumers (B2C), other businesses (B2B), and governments (B2G). Each of these groups of customers represent a very different kind of business for companies, to an extent that some devote a completely different business unit to better address each of these markets' needs. At this level of analysis, it is important not to micro-segment given that we are still only defining the business the company is in. For example, from a business standpoint, does it really make a difference for Montblanc to sell a pen to a young female professional or to an older male retiree? Not at all; both consumers would go to any Montblanc brick and mortar or online retailer to purchase a pen. However, selling to a company that requests 150 pens with its corporate logo engraved on each would represent a different business for Montblanc. This corporate consumer might contact Montblanc directly to order the 150 pens and Montblanc would be happy to fulfil this order. Similarly, government customers represent a different kind of business for a company given that governmental purchases are normally initiated through a procurement process. In sum, the possible "*who's*" in a reference market are those that represent "different battles" for the company. Finally, the *how* of the reference market responds to all of the possible alternatives that can solve the need defined in the *what*. In other words, with the *how* of the reference market we identify all of the substitute products, services or technologies that consumers might use to solve the need; we identify 'how else' the need could be solved. It is very important that the alternative technologies that could satisfy the need within the reference market be truly substitute products and not complements. In the case of Montblanc, a graduating student might receive a portfolio, a tie, or jewellery as a gift (not surprisingly Montblanc has developed brand extensions in all these "gift" categories).

From this point forward, each step of the process will be illustrated with a fictional example for Yoplait yogurt. (Please refer to the Appendix for the detailed illustration of the 8 step segmentation process): If Yoplait yogurt identifies its reference market as being in the business of "health", the competitive technologies for providing health could be, for example, granola bars, smoothies, or fruit, and not a gym membership or running shoes. Clearly these last two technologies are also in the business of health; however, people who go to the gym or for a

run are normally those who will eat the healthy yogurt. In other words, the consumption decision for these technologies is complementary, or could be assigned to a different budgetary allocation, than the consumption decision for a healthy snack

### ***Step 2- Selecting a macro-segment***

Once the reference market has been defined, the next step in the segmentation process is to elect one macro-segment or product market. According to Lambin (1997), a macro-segment is a combination of one *what*, one *who*, and one *how*. So for example, if we continue describing the segmentation process for the yogurt brand, we could say that the selected macro-segment to analyze is the one that's configured by the "health", the *who* "consumers", and the *how* "yogurt". This macro-segment can be described as offering health to people/consumers with yogurt. Although in the real world companies are focused on multiple product markets, sometimes managed by different business units, for pedagogical purposes I suggest that students focus on only one macro-segment to learn how the remaining six steps are developed.

### ***Step 3- Identifying variables for micro-segmentation***

The third step of the segmentation process could be considered the first step of what traditionally has been called micro-segmentation. In contrast to macro-segmenting where we asked the questions *what*, *who* and *how*, the question to ask to begin micro-segmenting is *why*? Why is it that consumers could be interested in the solution we are offering? By understanding the motivations behind consumers' intention to purchase, we can identify different groups of people that relate in a way that allows for creating segments. These motivations could be explained by the static variables we have previously discussed, but most commonly it is possible to find reasons why that transcend these static variables and provide more insight. For example, if we were trying to understand why people are trying to satisfy their need for health with yogurt, we might find that there is a group of people that are motivated by the nutrients yogurt provides, while another group of people is motivated by the potential weight-loss benefits. However, depending on the category being analyzed and the way that reference market has been defined, different kinds of variables could shed some light on why consumers make their choices. This is why in step 3 all possible variables that could explain different decisions should be identified: psychographic, demographic, and/or socioeconomic.

### ***Step 4- Choosing variables for micro-segmentation***

Once we have identified all the possible variables that could explain consumption behavior, the next step is to select some variables in order to segment the market. Although statistical software can generate clusters with multiple variables, for pedagogical purposes I recommend that only two or maximum three variables are chosen to segment the market. The variables that are selected must be the ones that the marketer believes provide deeper insight into why consumers make the consumption decision. These variables would have been previously identified after conducting extensive exploratory research to understand the different motivations. So in step 4 we make a strategic decision by selecting the variables we believe will allow us to classify the consumers within the product market in ways that are relevant for the company and the brand, and be beneficial to the company's bottom line (i.e., by generating a

competitive advantage). Continuing with our yogurt example, two variables that could have been chosen that respond to why people are looking for a healthy snack solution could be the level of interest in losing weight and the level of interest in performing well in sports.

### ***Step 5- Operationalizing the selected variables***

If step 4 has been performed correctly, the variables selected will be very insightful about consumer motivations but, for the same reason, normally difficult to measure. Operationalizing each of the selected segmentation variables is crucial for the implementation of the segmentation strategy. In other words, it does not suffice to just intuitively understand what makes consumers tick, but it is also necessary to find ways to measure those motivations. Hence, step 5 is where we develop these measures. This is not an exact science, more consumer data and information would make this step easier. However, when developing a segmentation strategy within a classroom, step 5 can become a great challenge since strategic intelligence/intuition is a key for completing this step. However, any approximation that is intuitively solid should suffice. Taking into consideration the two variables we chose in step 4, it seems to be true that understanding how much people want to lose weight or how much they want to perform well in sports could be very insightful for a firm selling yogurt. So, how do we measure this level of interest? Should we ask the consumer on a scale from 1 and 10 to tell us how important it is for them to lose weight? Let us suppose that subject A answers 7 and subject B answers 9. How can we really know if A's 7 is not higher than B's 9? We cannot. Therefore, it is crucial to come up with some sort of objective measure that allows us to discriminate between different types of consumers. An example would be to ask consumers what percentage of meals they prepare themselves at home. If subject A responds 85% and subject B responds 20%, then we have a more objective and measurable way to assess the level of interest a consumer has in eating healthy and losing weight. In a similar manner, the level of interest in performing well in sports could be gauged by measuring hours a week they workout. Increased experience and knowledge of the market will lead to identification of better ways to operationalize the variables for micro-segmentation. The challenge for the student in this step is to come up with an objective way to measure the level of interest or degree to which the selected variables describe each consumer.

### ***Step 6- Micro-segmenting***

Having found a measure for each of our chosen variables, we are ready to segment the market. If the chosen metric to measure a variable is discreet, deciding how to demarcate segments might be more straightforward. However, if the metric is continuous, some strategic intuition is again needed. After all the previous analysis and understanding of the market, the marketers should have a pretty good idea of how it makes sense to split the market. The number of splits or cells in the segmentation matrix is another crucial decision. If we split each variable in two, we will have a total of four segments. However, if we split one or each variable in three, we will end up with six to nine resulting segments. Therefore, it is also very important that marketers assess what makes the most sense, as the resulting segments must be measurable, substantial, accessible, differentiable, and actionable (Kotler and Keller 2008). If we are dealing

with segmentation in a very mature – hyper-segmented – market, then a higher number of splits will be more useful. However, if we are in a new or growing market, it will be better to have fewer splits for each variable. We will explore this aspect of the process in more detail when we describe step 8. Step 6 is concluded after naming and describing in detail each of the resulting segments. The use of demographic, psychographic, and lifestyle characteristics is very useful for this purpose.

### ***Step 7- Electing target segments***

Once we have segmented the market, the next step is to select the target segments that the company wants to pursue. If the process has been followed correctly, the segments identified in step 6 comprise all of the market interested in solving the need with the technology we offer. Each identified segment would represent groups of people that have similar characteristics based on the selected segmentation variables. In other words, people within each segment have similar levels of motivation based on the segmentation variables. Most likely, especially in mature markets, the company will want to focus not on the whole market but on only some of the segments that have been identified. This is why we select target segments. In the case of our yogurt example, we might want to focus on those people that are interested in performing well in sports without really caring much about weight loss, because our specialty is a yogurt that is prepared with whole milk and has a high level of protein content. In the case of a brand such as Yoplait, that offers low fat yogurts, and its brand promise is to keep you healthy and lean, the target segments it might go after are those that are motivated by a low caloric content given that the need they are trying to solve is losing weight.

### ***Step 8- Capturing the target segments***

The last step in the segmentation process is deciding how we are going to capture our target segments (cf. Kotler and Keller 2008). There are three possible strategies – undifferentiated, differentiated, and concentrated. An undifferentiated strategy would be when a firm goes after the whole market ignoring segment differences. A differentiated strategy would be either when a firm goes for the whole market recognizing segment differences or for a specific number of segments in order to specialize on a specific market interest. A concentrated, or niche, strategy would be when a firm focuses on one specific target segment. The strategy to choose depends on the profitability of each target segment and the company's objective. But most importantly, it depends on the level of maturity of the market. In mature markets we would have to select a differentiated strategy, regardless of the desired extent of market coverage, while in new or growing markets the strategy to follow should be undifferentiated in order to avoid hindering the market's potential growth. A concentrated strategy would make sense if we are following a niche competitive strategy or if the market is in the latter stages of maturity or decline. In the case of our yogurt example, assuming that the business of health is well established but still growing, maybe in the latter stages of growth, we could argue that it would be appropriate to follow a differentiated strategy. For more on strategic decisions based on the stage of the solution life cycle please consult Lambin (1997).

### 3. Conclusions

This paper describes an eight step process for teaching market segmentation. The eight step process allows for students to intuitively understand the competitive actionable power of a meaningful segmentation. It seeks to highlight the importance of basing the process on consumer insights and staying away from product-characteristic-led segmentations which lead to product oriented businesses. As a competitive tool, this segmentation process should lead to measurable, profitable, and accessible segments based on a business definition that provides value for the customer. We would expect competitive brands to differ in how they segment their markets, with each segmentation strategy unique in how it serves as a foundation for differentiation and brand positioning. In other words, if the illustrated example would have been for a different brand of yogurt that focuses less on health and weight loss and more on a sensorial or adventure type experience, the eight steps for this yogurt brand would have been different.

As with any strategic tool, the key to success with this segmentation process is repeated use. As previously mentioned, the best way for students to learn the process is through an experiential project or case study performed in teams. Additionally, since this is not an exact science, students that go through the exercise typically benefit from group discussion and decision-making. However, the more the students have access to real consumer insights and real market information, the better for the end result. Most problems students experience arise when moving from the theory to the implementation. Most 'first-timers' are confused on steps 4 and 5. It is therefore important that the instructor makes sure that insightful and relevant variables are selected before how to measure them is decided. The easy way out is to come up with measurable variables that do not provide any insights into why consumers make their decisions. Another common mistake is to decide on capturing the target segments with a strategy that is not consistent with the current market circumstances – e.g., focusing on a differentiated strategy when the market under analysis is clearly still in early stages of growth. For these reasons, practicing the eight step process under a heavily coached environment, such as part of a formal class project, leads to the best results. Finally, it is worth pointing out to students that segmentation is not only a tool for big and consolidated companies. For entrepreneurs and small business owners, a segmentation strategy may be the most important marketing tool they use, as it will not only clarify for them the business that they are in, but also who they should consider within their competitive set, and the most efficient way for them to define and capture their intended target market.

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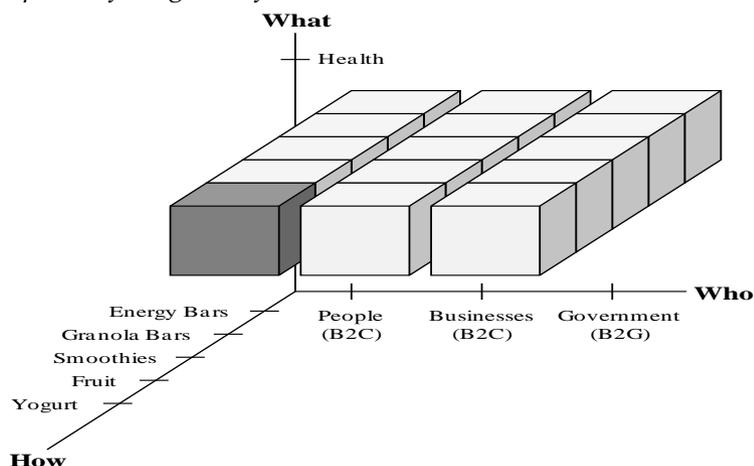
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## APPENDIX

### The Eight Step Segmentation Process for Yoplait Yogurt

#### Step 1- Defining the reference market



#### Step 2- Electing a macro-segment

From the 15 identified macro-segments, we select the highlighted product market. It can thus be stated that the firm is the business of providing: health for people with yogurt.

#### Step 3- Identifying variables for micro-segmentation

(These are only a few possible examples)

- Searched benefits: taste, value, covering nutritional needs, losing weight, feeling well, performing well in sports
- Demographic variables: gender, family size, income, age, lifecycle stage, profession
- Psychographic variables: lifestyles, personal values, activity level, self image, eating habits

*Step 4- Choosing variables for micro-segmentation*

- Level of interest in losing weight
- Level of interest in performing well in sports

*Step 5- Operationalizing the elected variables*

- Level of interest in losing weight: percentage of meals that a person prepares for him/herself
- Level of interest in performing well in sports: hours on average that the person works out

*Step 6- Micro-segmenting*

|   |               | Level of Interest in Losing Weight<br>(% of meals a week prepared by themselves) |                          |                                 |
|---|---------------|--|--------------------------|---------------------------------|
|   |               | Low<br>0-20%   | Med<br>21-50%            | High<br>>50%                    |
| Level of Interest in Performing well in Sports<br>(# of hours a week working out) | High<br>>9hrs | The football player  | The martial arts sensei  | The professional dancer         |
|   | Med<br>3-9hrs | The "I love to play but also to eat"   | The recreational athlete | The "I want to have a six pack" |
|   | Low<br><3hrs  | The couch potato   | The fit dude             | The "it's all about the looks"  |

In this step each of these segments must be described in detail.

*Step 7- Electing micro-segments*

Assuming that Yoplait's objectives were to be perceived as the zero fat healthy yogurt of choice, the logical segments to target would be those that share a high level of interest in losing weight: the professional dance, the "I want to have a six pack", and the "it's all about the looks" segments.

*Step 8- Capturing the micro-segments*

Given that we have assumed that the business of health is well established but still growing, maybe in the latter stages of growth, appropriate to follow a differentiated strategy.

*Note: All of the assumptions made in this example are only appropriate for explaining the eight step process, but would have to be confirmed in case the process was being applied to a real case.*