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Consumer Segmentation

A Call to Action



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Segmentation—once hailed as the Holy Grail for identifying growth opportunities in consumer businesses—has come under a cloud in recent years. It’s not that segmentation isn’t a useful tool. If companies weren’t able to de-average their consumer base, their marketing activities would wander off in the general direction of a theoretical “average” consumer. But too often, as a result of poor execution, segmentation efforts fail to deliver the value that companies expect.

We often hear executives complain about conflicting segmentations (“All the brands in the category have their own segmentation study, and each study seems to view the market differently”), segmentations that don’t lead to results (“We created some supposedly great segmentations, but then we didn’t know what to do with them”), and segmentations that are all right-brain and no left (“We conducted an attitudinal segmentation—it was very creative—but no one could figure out the economic implications”). The common theme is that many segmentations don’t lead, systematically and directly, to business actions that create measurable value.

There *is* a better way. The Boston Consulting Group’s approach to consumer segmentation begins where others stop short—with the requirement that the segmentation effort be designed to yield specific business actions that will result in a measurable improvement in financial performance. To realize that objective, we add to traditional segmentation methodologies three areas of focus: category involvement, segment profitability, and opportunities for action. Explicitly addressing these factors allows us to identify the segmentation scheme that will have the greatest financial impact. Using this approach, we’ve helped companies discover the most promising levers to drive profitable growth, and we’ve seen them unlock as much as \$1 billion in value from new opportunities born of a single segmentation effort.

Before we describe our approach, we’d like to set the stage with a brief discussion of how segmentations are generated and the choices to be made in developing the best ones.

The Art and Science of Segmentation

Like almost all consumer research that yields insight, segmentation should be based on a combination of

qualitative and quantitative data. The qualitative-research phase uncovers the attitudes behind consumer behavior in a specific category. It allows a company to experience its category from the consumer’s perspective and learn how consumers think about, shop for, and use its products. But segmentations should never be determined by qualitative research alone. To assess the size of the prize, companies must support their segmentations with a rich set of quantitative data on the behavioral and attitudinal factors identified in the qualitative phase.

What many executives are surprised to learn, however, is that even quantitative surveys do not yield *definitive* segmentations: each segmentation is the result of myriad judgment calls about how the surveys themselves should be designed and also how the data obtained should be analyzed. Although most people understand that survey design requires many choices and tradeoffs, very few realize that any given data set from a quantitative survey can produce numerous statistically significant segmentations. Different analyses result in different segmentations, and identifying the one that will create the most value for the business isn’t easy.

That difficulty is often compounded by the fact that the hundreds of important decisions that go into a segmentation are typically made by an outside agency, which has been contracted by the market research department and is many steps removed from the CEO and business executives who drive company strategy. This weak link increases the chances of suboptimal decision making because the core strategic questions are not effectively addressed by the segmentation. Too often, the result is a segmentation that fails to drive business improvement.

Segmentation, then, is both an art and a science. The art is to effectively structure the research—both qualitative and quantitative—to ask the right questions and draw the correct inferences from the responses. Art is also involved in determining what questions to ask, how to phrase them, and how to structure the analysis (which questions should drive the segmentation, for example). Finally, there is an art to sifting through multiple segmentations (applying judgments based on both the qualitative research and an understanding of the company's strategic landscape) until the optimal solution is found. At the same time, science is involved in the measurement and validation provided by the quantitative research, ensuring that the optimal segmentation is statistically significant and provides for maximum economic growth.

Below we detail the three critical factors—category involvement, segment profitability, and opportunities for action—on which we believe a segmentation must focus in order to deliver on its promise and produce significant value. All of them should

be explored in the qualitative research, addressed explicitly in the quantitative research, and used as the main drivers of results in the analysis phase. The objective of our approach is to help executives reduce the risk of generating an inef-

Segmentation brings art and science to understanding consumer behavior.

fective segmentation by guiding them in the art of decision making.

Focusing on Category Involvement

Category involvement—a multidimensional measure—assesses the degree to which consumers consider a product category important given their needs, emotional makeup, values, and interests. It takes into account the time they spend thinking about products in a category, reading about them, learning new things about them, talking about them, and shopping for them. It also considers frequency or depth of use, knowledge or expertise, and the amount of money spent.

In our research on trading-up and trading-down trends over the past several years, we have documented the degree to which individual consumers' shopping behavior differs from one category to the next. For instance, some consumers may pay top price for chocolate for themselves but feel that private-label dog food is good enough for their pet. In fact, most consumers can identify at least a couple of categories for which they have a special affinity ("I'm a

wine connoisseur" or "I need a special closet just for my shoes"). Such shoppers may make up as little as 20 percent of the consumers in a category but may be responsible for as much as 70 to 80 percent of its sales—through a combination of direct purchases, the recommendations they make, and the gifts they receive.

Attitudes and the behaviors they give rise to vary by category and individual. Two people of the same age, race, income, and hometown will often make very different choices about when and where to splurge or economize in a given category. Therefore, sociodemographic segmentations are mostly inadequate at predicting consumer spending. They may make it easy to identify and track consumers, but they don't necessarily lead to effective actions differentiated by segment.

Lifestyle segmentations aren't much better, because they presume that people who have one thing in common have most things in common. A lifestyle segmentation, for example, might tell an apparel company how many of its customers consider themselves trusting or adventurous. But it would be more useful for the apparel company to know the characteristics and number of consumers who are very emotionally involved in apparel and, within that set, which consumers prefer a classic as opposed to a modern look.

There are times when an occasion-based segmentation may prove more effective than one that looks at consumers alone. Take shoes, for instance. In the past, most people had one pair for dress occasions, one pair for everyday use, and maybe another for sports activities. Now there

are different kinds of shoes for just about every sport, and dress shoes for many different occasions. An occasion-based segmentation uncovers new opportunities for the company, which may be offering products in only a subset of consumer-defined occasions.

These observations have two implications for the segmentation process. First, segmentation surveys should focus on category-specific attitudes and avoid general questions not relevant to the category, such as whether people consider themselves shy or outgoing. Second, category-specific attitudes rather than sociodemographic variables should drive the segmentation algorithms. And once the segments are defined, profiles of consumer behavior should be developed in each segment to confirm that attitudinal differences among segments are borne out in a range of behaviors. Thus, the explanatory power of the segmentation comes from the link established between category-specific attitudes and the particular kinds of behavior they produce. This link is critical for ensuring that actions undertaken to change perceptions will ultimately drive changes in consumer behavior and improve the business.

Analyzing Segment Profitability

We differentiate consumers by their profitability in addition to their involvement in a category. That helps to prioritize investments in business actions intended to promote segment growth. For instance, two consumer segments may both be highly involved in a category in terms of attitudes and volume of purchases, but one may be very sensitive to price

and always buy merchandise on sale, whereas the other may value time over savings and typically pay full price. Our surveys are designed to capture such differences by looking at the proportion of consumer spending by channel, the frequency

Segmentation surveys should focus on category-specific attitudes.

of splurging or trading up in the category, and the proportion of buying at full price versus taking advantage of discounts, sales, or promotions.

Too often, consumer segmentations that divide the market into groups with catchy names don't provide insight into the economics of each segment and its contribution to profits in a particular category. To model a segment's economics, it is vital to understand consumers' total spending in the category as well as their propensity to pay premium prices. That allows the company to quantify profit pools by segment and prioritize them accordingly. Even in an uncertain economy, there remains in almost every category a segment of highly involved and highly profitable consumers whose emotional attachment to the category largely insulates it from the economizing decisions that consumers make elsewhere to cut back.

Identifying Opportunities for Action

Beyond finding potential profit pools, our approach to effective segmentation also requires a company to determine up front which business ac-

tions it intends to take as a result of the effort. There are several possible levers to improve value creation:

- ♦ Pricing and promotional strategies
- ♦ Consumer marketing messages and channels
- ♦ New products and subbrands (different features and attributes)
- ♦ Customer retention strategies
- ♦ New retail concepts

In an effort to elicit the best responses, most researchers limit their quantitative surveys to 20 or 30 minutes. But this isn't enough time to explore the potential results of all the actions a company might contemplate taking to improve performance. Therefore, a critical element of our approach is to begin with clear hypotheses about which actions will achieve the company's objectives and then to make sure that those actions are addressed in the research design and analysis.

Insights about how to make the selected value-creation levers more effective point toward opportunities for action. For instance, in our work with a hotel chain, we chose direct marketing to help optimize the business, focusing on understanding which customers were more or less likely to respond to promotional offers. As a result, the chain was able to customize its promotions by type of customer and occasion. (Customers traveling on business, for example, were offered a free weekend rather than the third day free.) Another segmentation aimed at increasing awareness of a brand, so we analyzed consumers' exposure to different media, as well as the demo-

graphics of each segment, for the purposes of future media buying. Efforts that fail to prioritize segments and to identify different opportunities for action in each of them amount to little more than an intellectual exercise and yield few meaningful results.

Some managers wonder whether they should undertake more than one kind of segmentation effort. We recommend that every company have a single, consistent *strategic segmentation* that includes all the possible consumers in its market and defines its category as broadly as possible. Depending on the category, this effort should be updated about every three years. One result will be a short set of questions that will help to classify consumers in subsequent research projects into strategic segments. That will allow the company to conduct a “deep dive” with the most attractive segments in order to explore tactical issues and follow up as needed.

Enlisting the Organization

As good as a segmentation effort might be, its value will be wasted unless the whole organization embraces it. Too often, critical insights aren’t realized, because top management is not directly engaged in helping to shape the effort. At other times, functions that haven’t been directly involved don’t fully understand the findings and won’t act on them. Few CEOs would be willing to reorganize an entire business on the basis of an effort undertaken by the consumer research department in isolation. For research to have the greatest impact, business executives must be directly involved from the beginning and take ownership of the research.

Persuading the whole organization to support the opportunities and actions resulting from a segmentation should be an integral part of the effort, not an afterthought. For example, we found seven potentially valuable consumer segments for an

Segmentations designed for action can create tremendous value over the long term.

apparel retailer. After identifying the most attractive one (consumers who were highly involved in apparel, most aligned with our client’s fashion positioning, and least sensitive to price), we developed a plan to respond to this segment’s unmet needs. Those insights became the basis for an offsite strategic-planning meeting, a brand-repositioning effort, a new ad campaign, and a redesigned product-development process. We spent as much time communicating the results of the segmentation study—through multiple presentations, Q&A sessions, and one-on-one meetings—as we initially spent developing the segmentation. Getting everyone in the company to understand and support the strategy was what made the difference between an insightful segmentation and measurable business results.

Segmentations that are designed for action and based on category involvement and profitability can create tremendous value over the long term. They can help a company define a new space for growth, reverse a sales decline, react to a competitive threat, and—per-

haps most important—determine where and how to compete. They can also align marketing and sales across the organization—for example, to identify a growth area that needs its own business unit, including a marketing and sales team. Or they can suggest a reorganization of the marketing department to capitalize on different opportunities by segment, pulling all the company’s value-creation levers together.

At the very minimum, a segmentation should answer the following questions in order to be successful:

- ◇ Which consumer segments represent the largest profit pools in our category?
- ◇ What is our share of wallet across segments today?
- ◇ How should we prioritize the various growth opportunities within and across segments?
- ◇ What messages and offerings will command the attention of these consumers?
- ◇ How can we position our brands and subbrands for growth against competitors and one another?
- ◇ What changes in product offerings, service, and brand perception should we make in order to increase share among targeted segments? How are these changes best achieved?

The ultimate results of an action-based segmentation are a stronger competitive position, a clear view of the markets that are ripe for successful competition, and a plan for achieving the potential advantage.



About the Authors

Mary Egan is a partner and managing director in the New York office of The Boston Consulting Group. You may contact her by e-mail at egan.mary@bcg.com.

Jean-Manuel Izaret is a partner and managing director in the firm's San Francisco office. You may contact him by e-mail at izaret.jeanmanuel@bcg.com.

Mary Egan and Jean-Manuel Izaret are on the global board of advisors of BCG's Center for Consumer Insight (CCI), which provides world-class consumer-insight capabilities to BCG's clients. Established by the Consumer practice and the Marketing and Sales practice, the CCI leads the firm's proprietary research for publications on consumer trends and purchasing patterns. As an advisor to companies in many industries, BCG has long recognized the fundamental value of identifying and leveraging consumer insights for strategy development and as a key source of sustainable competitive advantage.

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For Further Contact

For further information about the topics discussed in this report, please contact either of the authors.

BCG's Consumer practice and Marketing and Sales practice cosponsored this report. For inquiries about these practices, please contact their respective global leaders:

Patrick Ducasse

Senior Partner and Managing Director
BCG Paris
ducasse.patrick@bcg.com

Miki Tsusaka

Senior Partner and Managing Director
BCG Tokyo
tsusaka.miki@bcg.com

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