

Innovation Toolbox

Connect with the Market – Market Segmentation

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1.0 MARKET SEGMENTATION

1.1 Segmenting your market

Your market is a group of individuals or organisations that are potential customers for a product or service and market segmentation is the dividing of a larger market or industry into a number of segments (identifying groups and sub-groups). You may choose to focus marketing activities in one or more these market segments – your target market(s). You segment because:

- ➔ Not all buyers are alike.
- ➔ It's easier to satisfy smaller groups with similar behaviour, values and/or background.
- ➔ Some segments may be easier to access and also offer greater profit potential.

The idea behind market segmentation is to enable you to choose one or a few meaningful segments and concentrate efforts on satisfying them. Common characteristics to broadly segment a market/industry:

Individual consumer markets -

- ➔ Demographic - size, composition and distribution of the human population (age, sex, race, ethnicity, marital status, family size, family life cycle)
- ➔ Socioeconomic – occupation, education, income, social class
- ➔ Psychographic/lifestyle – activities, interests, opinions, values
- ➔ Geographic – continent, political boundaries (country), cultural region, metropolitan area, climate, natural resources
- ➔ Behaviour patterns – heavy users vs. infrequent users, loyalty to brand or store, benefit expected (product needs), importance of price.

Business markets -

- ➔ Geography – political boundaries (cities, states, etc.), domestic/international boundaries
- ➔ Organisational characteristics – industry type, organisational size, technology used.
- ➔ Purchase behaviour and usage patterns – order size (heavy vs. light usage), centralised vs. decentralised purchasing, type of rebuy (e.g. straight rebuy vs. new task)
- ➔ Organisational predisposition or policy – product knowledge, benefits sought, organisation problems, multiple vs. single supplier policy.

1.1.1 Identifying the right segment

Certain information should be known about each market segment before selecting the segment which appears the most meaningful/beneficial to target. The following criteria should be known before making any decision:

- Current demand for the product (market size) – sales, units, number of users, potential share of the market.
- Customer profiles – purchasing behaviours, market gaps (areas where needs are not currently being met).
- Future potential for the product - market growth rate, position in the product lifecycle, trend analysis - conduct a 3-5 year forecast.
- Competitor profiles– number and size of firms and what are they doing to satisfy your potential customers.
- Frequency of new product introductions and emerging technology.
- Threat of potential entrants.
- Bargaining power of suppliers
- Competitive rivalry.
- Distribution networks.
- Entry barriers – capital investment required, extent of economies of scale, access to distribution channels, unions, consumer acceptance/brand recognition, and opportunities for product differentiation.
- Exit barriers – length of time needed in the market to honour labour contracts, length of existing leases, services and parts provided to customers, government regulations and outside obligations to warehousing or financial institutions.
- Economic systems and conditions – allocation of scarce resources, competitive structure (does a monopoly exist in the market?), the business cycle (prosperity, recession, depression, recovery).

1.1.2 Which segment should I approach first?

Based on the analysis of the different market segments, ask yourself:

- Which segments have the highest degree of similarity in their needs and are the most distinct from the other segments? Are these distinguishing characteristics stable over time?

- ➔ Which segments have market potential of significant size? Is there a demand for the product which is large enough to be profitable?
- ➔ Which market segments are most accessible through distribution efforts or reachable through promotional efforts? Which segments have minimal barriers to entry?
- ➔ In which segments are you most likely to develop a sustainable competitive advantage? If you ignore any particular segment will it give a competitor the opportunity to grow and encroach on your core markets?
- ➔ Which market segments are growing? Is there a high introduction of new products?
- ➔ In which segments are you most able to satisfy the market requirements/needs given your current organisational objectives and resources?

1.1.3 How can I approach the customers in my target segments?

Now that you have profiled your ideal customer in your preferred market segment, you need to consider the most effective way to tell them about your new idea or innovation. These are some of the methods by which you construct the compelling reason for customers to buy your new innovation or otherwise benefit from its creation:

- ➔ Undifferentiated marketing
 - Mass marketing – selecting all segments.
 - Useful when there is little diversity among market segments.
 - May result in savings in production and marketing costs.
- ➔ Concentrated Marketing
 - Selecting just one segment.
 - Can gain competitive advantage by specialisation.
 - May be too narrow, and high competition in that segment may prove it to be unprofitable.
- ➔ Differentiated Marketing
 - Different buyers, different strategies.
 - Multiple market segmentation.
 - Maximise market share.
 - Extensive resources required.
- ➔ Custom marketing
 - Satisfying each customer's unique set of needs.
 - Going one on one with customers.
 - High marketing costs.

Once a decision has been made on which approach to take, a thorough analysis of your potential collaborators in these target segments must be undertaken so appropriate pricing and distribution strategies can be developed.

1.1.4 How do I reach my target customers?

You essentially have two choices when deciding how to connect your new idea or innovation available to your customers:

- ➔ Distribute the product yourself, or
- ➔ Distribute through intermediaries.

Gaining access to appropriate distribution channels is one of the most critical success factors to your new idea because it is the physical bridging of the gap between you and your ideal customers.

The industry you are in and/or the market you are servicing will largely determine how you distribute the idea or innovation, because they are traditionally already in place, unless your idea is a ground-breaking, radical innovation and new to the world, which may require new thinking and different approaches. Further, with the speed and efficiency of the internet growing daily, traditional distribution channels are narrowing. Nevertheless, for the purposes of illustration, the logistics of moving products around are generally the same, and typical channels of distribution include:

A. Manufacturer----->Consumer

B. Manufacturer----->Retailer----->Consumer

C. Manufacturer----->Wholesaler----->Retailer----->Consumer

D. Manufacturer---->Broker----->Wholesaler----->Retailer----->Consumer

The functions performed by these intermediaries include:

- ➔ Physical distribution – Materials handling, order processing, inventory management, warehousing and storage, transportation, packaging and containerisation, sales force.
- ➔ Communication (a selling function) – Promotional programs, informing buyers how products are to be sold, used, repaired, or guaranteed.
- ➔ Facilitation – Providing extra services, collecting market intelligence, financing, offering credit, taking risks.

You will want to choose the distribution method best suited for your product and where you want to be positioned in the marketplace. Your earlier market research should have revealed the nature of distribution channels for your new idea and innovation so your options may already be available. Nevertheless, deciding on the distribution channel and how many levels and the specific type of intermediaries to be selected at each level, depends on a number of factors such as:

- ➔ Product - value, perishability, technical complexity, complexity of product application, brand image (is it a speciality or convenience product), stage of product life cycle, breadth of product line, supporting services required.
- ➔ Market - potential size, concentration of buyers, barriers to entry (in particular, government regulations), end-user preferences, size and frequency of purchases, environmental stability (political, currency fluctuations etc.), risks of non-payment.
- ➔ Producer/Manufacturer – distribution capabilities, financial strength, management skills, services needed, prevailing distribution practices, existing channels, co-operative promotional program, target market strategy (concentrated or mass marketing), promotional strategy (how important is personal selling).
- ➔ Competition - competitor distribution strategies, agreements with distributors.
- ➔ Channel participants– capability of satisfying target market needs, availability, revenue-cost analysis, control considerations (how important is it to have control over product marketing, brand promotion, product servicing, market information for feedback), legal requirements, market coverage.
- ➔ Costs/Return - Is the gross margin and volume potential in your target market high enough to afford a stronger presence in the market (eg. a representative on the ground)? Could turnover be improved with a stronger presence in the market? Can costs be reduced by local assembly or local contract packing? Could a better price be won for your product if it were marketed more strongly?