Business Segmentation: Emerging Approaches To More Meaningful Clusters

By Michael Richarme

Consumer opinion research has a well-established track record, stretching over the past five or six decades. Conducting opinion research among businesses, however, is much more problematic. This is particularly evident at the simplest level of analysis, customer segmentation. However, segmentation techniques are evolving, and techniques that were common practice in the recent past are rapidly being supplanted by newer, more meaningful segmentation techniques.

Though the process of business segmentation can be resource-intensive, it can be accomplished as an evolutionary process that gradually adds more information and understanding to your firm's decision processes and, ultimately, to your firm's profitability.

The underlying purpose of segmentation is to divide customers into distinct groups, such that marketing messages can be tailored to their specific needs. There are some general criteria for the establishment of these distinct groups. The groups of customers, or segments, should share more commonalities within each group than there are between groups. The segments should also be large enough for organizations to mount cost-effective campaigns and should be reachable through most media avenues.

Describing consumer households in the past was simply a matter of gathering relevant demographic information and performing a cluster analysis. Demographics for households were fairly straightforward, in that the decision maker was generally identifiable without much effort, and the demographic categories were standardized to a great degree by the United States Bureau of the Census, aided by population parameters generated each decade by the Census Bureau.

That approach yielded groups of homogeneous consumers who had similar demographic characteristics. It turned out that people who consumed Moon Pies in the deep South were indeed different from people who consumed vegetarian quiche in California, or people who indulged in cheese fondue in the upper Midwest.

Organizations rapidly discovered, however, that simple demographic segmentation had severe limitations when it came to gaining a better understanding of the decision-making process that was taking place in the households. So most future-thinking researchers began adding questions to their instruments to pry apart this complex process. The simple demographic-based segmentation approaches gave way to psychographic segmentation, focusing on lifestyle choices. Organizations had a better glimpse into the minds of their consumers and were able to better tailor their marketing messages. The concept of mass customization came into vogue, with effective marketing being conducted toward smaller and more unique segments of consumers.

Organizations, however, found it difficult to adapt these same segmentation concepts and techniques to the business market. Looking for alternative methods, many of them adopted what is generally referred to as firmographics, which rely on four main segmentation techniques.

The first technique, labeled Business Descriptors, was an even more ambitious attempt to classify businesses by specific descriptors, such as business revenue, number of employees, number of product lines, number of key competitors, market share, and similar items. However, many of these descriptors were not publicly available and, even more, added little information to the segmentation goal of describing unique groups of decision makers to whom a specific marketing message could be crafted and delivered.

The second technique, labeled Type of Business, attempts to divide firms into segments with a standardized classification scheme, such as the Standard Industrial Classification (SIC) code. Though generally available from public sources, this method also provides challenges when attempting to classify businesses that have many different lines of business.

The third technique, labeled Location of Business, examines the physical addresses of businesses and uses geography as the major clustering factor. While this approach may produce differentiated groups among organizations with one physical location, it becomes unwieldy when applied to geographically dispersed divisions, branches, or retail locations. This has implications for selling, for product delivery, for billing, for customer service, and for almost every other facet of a firm.

The fourth technique, labeled Revenue, simply breaks firms into size categories based on their revenues. This approach recognizes that even though a business might be small in comparison to others, it might also provide the organization with a more substantial revenue stream than that provided by other larger businesses.

Many of the techniques described above continue to be practiced in combination, often yielding presentations to senior management that contain beautiful pie charts and impressive data, but little useful information.

Taking a page from the consumer research handbook, business researchers then began developing psychographic-oriented segmentation tools. The development of these new tools necessitated the introduction of a new source of information to the researcher-internal information. While prior research had utilized both primary and secondary sources of information, both sources were acquired externally. Internal information, however, would allow researchers to tie business customer information to their internal accounting, manufacturing, and service databases and would represent a major evolutionary step forward in business segmentation techniques.

The first new technique, labeled Future Vision, combines several dimensions. Is this firm an innovator in product development, or a laggard? Does this firm adopt new business practices and models when appropriate, or does it attempt to force every decision through existing structures and practices? Is the firm guided by long-range strategies and plans, or is it susceptible to quarterly financial reports and investor pressures? Is this firm a leading-edge firm, or is it a dull-edge firm? This technique really addresses the mind-set of the decision makers within the firm, and it can be a valuable data point in developing a firm's positioning strategy.

The second new technique, labeled Criticality to Business Mission, examines the relationship between a firm's business mission and the product or service an organization is providing. For example, providing electricity to a small retail store is important, but an outage of a few minutes or even a few hours will cause inconvenience at best. That same electricity outage to a computer chip manufacturer would result in the loss of an entire production run, valued at millions of dollars, and would be deemed more than inconvenient by most observers. This technique really addresses the relationship between the firm and the products and services an organization provides, and it is a critical step toward differentiation.

The third new technique, labeled Level and Type of Decision Maker, begins to address the complex decision-making processes at firms. Among the questions it answers are: Is decision making centralized or decentralized? Is there a multistep approval process for large decisions, and is the approval process a rubber stamp or a thorough review? Are there decision influencers or gatekeepers, or is the decision process itself subject to group decisions? This technique really addresses the communication channels a firm must develop in order to ensure the marketing message is delivered to the appropriate decision nexus within the firm.

The fourth new technique, labeled Contribution Margin, addresses whether a potential customer's bottom-line profitability truly allows a worthwhile relationship. While a firm may generate substantial revenues, it may also utilize significant organization resources in terms of operations support, accounting processes, customer service support, and the like. How much of that firm's revenue stream really drops down to the bottom line? This technique really begins to involve the entire organization in the process of understanding its customer base and how some customers are worth more than others.

The four new business segmentation techniques are shown in the following table, alongside the four traditional techniques.

Traditional Business Segmentation	Emerging Business Segmentation
Business Descriptors	Future Vision
Type of Business	Criticality to Business Mission
Location of Business	Level and Type of Decision Maker
Revenue	Contribution Margin

Though some firms have been utilizing individual techniques like these for several years, the truly progressive and profitable firms have made inroads in the adoption of combinations of these new techniques that fit their business models.

If your firm provides goods and services to other businesses, it may be time to take a solid look at your segmentation techniques. Though the process can be resource-intensive, it can be accomplished as an evolutionary process that gradually adds more information and understanding to your firm's decision processes and, ultimately, to your firm's profitability.

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604 Avenue H East ■ Arlington, TX 76011-3100, USA
1.817.640.6166 or 1.800. ANALYSIS ■ www.decisionanalyst.com