

# SEGMENTING WHEN IT MATTERS



**Andreas Birnik** and **Richard Moat** argue that business complexity is directly linked to the degree of segmentation implemented by a company. They propose an approach to map business activities at the segment level to make sure that complexity is only introduced when it really matters to customers.

When it comes to serving customers, businesses can move in one of two fundamental directions. They can standardize operations so that every customer receives the same options and treatment as every other customer. Think of Henry Ford in 1908 talking about the fabled Model T: “Any customer can have a car painted any colour that he wants so long as it is black.” On the other hand, a business can try to operate so that every customer is treated, to the greatest extent possible, as a unique individual – a market segment of one, if you will. Henry Ford, after all, could have tried to create a company that offered *any* colour car that a customer asked for – with operations split into colour-coded divisions ending with a corporation in chaos.

While that second option makes for great marketing theory, it is, of course, impracticable for any company with a large number of customers. Nonetheless, we have witnessed on many occasions how segmentation champions inside companies have introduced unnecessary complexity and overcomplicated operations. The risk is perhaps greatest when a company makes the transition from a rudimentary segmentation model toward a more refined way of segmenting and servicing customers. In this situation, there is a clear risk that the pendulum swings too far and that business activities become overly segmented whether or not it actually matters to customers. This can result in fragmented operations driven more by the desire of segment champions to differentiate themselves internally within the organization than by actual customer needs.

## Sensible segmentation

The degree of complexity required to deliver a company’s desired customer experience is directly linked to what we call the segment range and the degree of segment differentiation. *Segment range* is the number of different customer segments that the company actively targets while the *degree of segment differentiation* is the extent to which a company tailors its business activities to fit the exact requirements of a particular segment.

The most segmented positioning option is what we call the *portfolio strategy with full segment differentiation*. To deliver this, the company fully differentiates all aspects of the customer experience by segment. This requires separate brand names, products and services and touch point experience. Hence, while Starwood Hotels & Resorts Worldwide operates St Regis, Sheraton, Westin and W Hotels, the customer experience is quite differentiated between the brands across a large number of factors. The complexity is the highest in this positioning option as it essentially requires separate operations to be fully implemented.

A company can also select to implement a *portfolio strategy with varying segment differentiation*. This means targeting different segments while limiting complexity by cutting back on some elements that could be tailored at the segment level. An example of this occurs when a company launches a low-cost brand in which price might be the only real differentiator.

A scaled-back version of the portfolio strategies mentioned above is the *niche strategy with maximum differentiation for one segment*. In this case, a company deliberately limits complexity by choosing to service only one customer segment and to gear all business activities towards delivering an experience tailored to the needs of the chosen segment. This is quite common for brands aimed at the luxury market, such as Aston Martin, Patek Philippe and Louis Vuitton.

At the other end of the spectrum is the *non-segmented mass market strategy*. This is essentially Henry Ford’s one-size-fits-all approach. With this positioning option, customers are typically offered a good product at an attractive price, which makes them select the product over more segmented offerings that might genuinely suit them better but come at a higher price. Such practice occurs in diverse industries including low-cost airlines, fast-food restaurants, virtual mobile operators, VoIP phone operators and discount retailers.

There are two more options that should be mentioned. Consider the company that puts forth a *core offering across segments with deep segment differentiation* – or a *core offering across segments with some segment specific differentiation*. These two options are interesting to study because they deliberately seek to limit complexity by creating a strong core offering across segments together with segment specific differentiation. This means sharing some offer elements across segments (such as brand name and distribution channels) while other components (such as price, products and promotions) might be varied. This is quite common in the automotive industry; think of BMW and Toyota. It is worth noting that while this approach can work well across multiple segments, the core offer component makes it difficult to stretch this approach across a too-wide range of segments. Hence, Toyota created Lexus as a separate brand catering to the prestige market.

## Segmenting when it matters

The objective when using segmentation should be to strike an appropriate balance between maximizing a segment-specific customer experience while minimizing operational complexity. In short, managers should segment those activities that really matter to customers and otherwise simplify operations. So how should a manager figure out →

→ which activities to differentiate by segment, which to share across segments – and which to eliminate altogether?

The first question to ask is what really matters to the group of customers that constitute a segment. W. Chan Kim and Renée Mauborgne designed a “strategy canvas” ([www.blueoceanstrategy.com/abo/strategy\\_canvas.html](http://www.blueoceanstrategy.com/abo/strategy_canvas.html)) that we recommend highly. In essence, Kim and Mauborgne suggest that you think of your market offering against a number of factors, while also plotting how your competitors are segmenting their offerings. The logic is then to make sure that you differentiate on those competing factors that are most critical for a particular customer segment while you standardize, or even eliminate, those competing factors that are of less importance. This will ensure that “key hooks” are in place for particular customer segments while operational complexity is kept at a minimum.

### Segment activity grid

During the past five years, a telco we formerly worked for has gone through a transition period from a rather rudimentary segmentation approach consisting of (1) business versus consumer and (2) prepaid versus postpaid. In time, it moved toward a more elaborate needs-based segmentation approach with a large number of consumer and business segments. The guiding objective for the company was to introduce pan-European segments and to direct central development efforts towards servicing the most valuable segments on aggregate across Europe.

As a result, central teams were put in charge of developing propositions for each segment and rolling these out across the footprint. During such a transition, there is always a clear risk that the pendulum swings too far with excessive segmentation as a result. As we have said to any number of managers, if segmentation becomes a marketing “hammer”, every customer can look like a different kind of “nail”. The outcome is ever-more granular segmentation of activities than actual differences in customer needs warrant, with a corresponding increase in operational complexity. The pendulum can also swing too far in the other direction and lead to one-size-fits-all propositions. In short, it can be a real challenge to get the balance right between customization and standardization. It was while wrestling with this challenge that we developed a helpful tool that you can use.

*The segment activity grid* is a one-page overview that shows similarities and differences in terms of how various customer segments are served. We developed this grid to get a visual overview of what activities varied at the segment level. The grid allows managers to design an approach suitable for their specific situation rather than to pick and choose from generic positioning options.

As a result, some activities may be uniform for all segments while other activities may vary by segment – and certain activities may be shared across segments. Activities may also *not* be performed for a particular segment, in which case the grid is left blank.

The grid as illustrated designates three customer segments and three business segments, six in all, marked A through F. The column titled “range” shows the number of segment-specific variations allowed for a specific business activity. Hence, if the range is shown as “1” for brand name, it means that the same brand name is used across all customer segments. With a range of “6”, as for product range in the illustration, it denotes that there are specific products aimed at each of the six segments.

In the event that a cell is left white, it means that no activities are targeted at a specific segment. Outbound pre-sales visits are an example of an activity that might only be targeted to certain business segments, while residential and small business segments are instead targeted through other less costly channels.

We found the segment activity grid very useful to obtain a comprehensive overview of the degree of complexity in the business. There is also a clear link back to the segment positioning options discussed above. For a portfolio strategy with full segment differentiation, we would expect to see a different colour in each column and no activities being shared across the segments. The segment activity grid would then show this as a number of completely separate silos. Correspondingly, a pure niche strategy would only go after one segment while the rest of the columns would be left blank.

The grid is useful in a number of different situations. It is clearly of value during launch preparations for a new company as it can help managers design an appropriate operating model showing the level of segment differentiation and operational complexity. In addition, the grid is very useful during a transition phase from a rudimentary segmentation towards a more sophisticated segmentation; it was in this context that we developed the grid. The grid can further be used to audit existing operations as part of a strategy review.

### Structure and strategy

Does strategy drive structure or structure drive strategy? The segment activity grid provides a novel perspective on this classic question. Some have argued (for example, Alfred Chandler) that strategy drives structure; others (such as Joseph Bower and Robert Burgelman) think the opposite. The segment activity grid provides a view of the customer-impacting activities in a firm’s value chain. When managers design the target customer experience by segment, and later adjust the value chain activities to deliver the desired segment differentiation, we

			Consumer segments			Business segments		
	Element	Range	Segment A	Segment B	Segment C	Segment D	Segment E	Segment F
Pre-sales	Brand name	1						
	ATL advertising	2						
	BTL advertising	4						
	Web site	2						
	Sales visits	1						
	Events	2						
Sales	Sales channels	3						
	Product range	6						
	Pricing	6						
	Packaging	6						
	Promotions	6						
Usage	Installation	1						
	Payment	2						
Post-sales	Service channels	2						
	Service levels	1						
	Billing	2						
	Loyalty programmes	2						
	Retention offers	2						

### Segment activity grid

clearly have a case of strategy drives structure. From this stance, it is the customer experience that is in the forefront; and, thus, activities and structure have to accommodate the strategic decisions being made by managers.

However, the opposite case is clearly also possible. We can easily see how managers might make decisions concerning specific business activities that have a direct impact on the customer experience. An example would be if a multinational telecom operator decides to purchase and deploy the same billing system in all countries in which it operates in order to generate cost savings. The subsidiaries will then have a billing system with certain technical limitations that restrict the type of rate plans and payment solutions offered to customers. The case then becomes one of making the best out of the structural limitations of a given technical platform rather than figuring out what would be “ideal” (from a customer experience perspective in a particular country). In such a business case, structure clearly drives strategy. The segment activity grid can help managers to better understand this interplay between strategy and structure.

Regardless of which approach is used, clarity and simplicity make the biggest difference in terms of maximizing the chances of marketplace success. In

our experience, it often gets messy as a company tries to translate a conceptual strategy into operational reality, necessitating managers to confront the reality of a myriad of business activities and multiple customer segments to serve. It is precisely in this situation that the segment activity grid can help a company to bring clarity and simplicity to complex business operations. ■

### Resources

Andreas Birnik and Richard Moat, “Developing actionable strategy”, *Business Strategy Review* 19, no. 1, 2008.

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