POINT OF VIEW

The Art and Science of Segmentation

May 30, 2014

IRi
Growth delivered.

The Art and Science of Segmentation

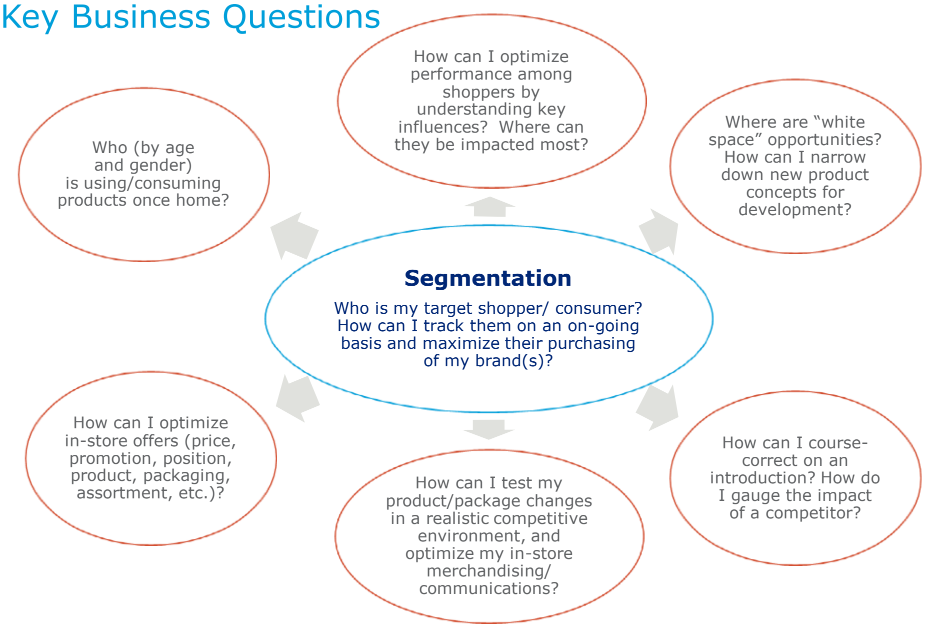
Introduction

In an era of tight marketing budgets, it's critical that consumer package goods CPG manufacturer and retail marketers concentrate their efforts on achieving five crucial goals: implementing a focused marketing strategy, expanding the reach of their marketing programs, retaining existing customers, improving communication, and enhancing the competitiveness of their products and/or channels.

Segmentation is a cornerstone of marketing planning and achieving these goals. Executed effectively, segmentation holds the promise of increased profitability and customer loyalty. As someone said, "It is not possible to be all things to all people, so market segmentation is the way to avoid this temptation."

At a recent IRI Summit conference, Frito-Lay Chief Marketing Officer Ann Mukherjee offered a powerful example of using creative drilling techniques to tap into oil pockets in otherwise depleted oil fields. She then drew an analogy to finding growth from what she calls "pockets of demand" within an otherwise mature snacking category. This helped Frito-Lay uncover a rapidly expanding, heavy-snacking consumer segment they christened the "Young and the Hungry," to which they were able to successfully market.

Effective Segmentation is the Foundation for Answering Key Business Questions



Effective segmentation provides a treasure trove of valuable information that can lead to benefits such as identifying white space for new product innovation, developing strategies for improving in-store offers and better understanding the influences that determine shopper purchasing patterns.

Especially when it comes to mature or maturing markets, growth is to be found in specific consumer "pockets" and not through broad-based initiatives. Segmentation provides the insights necessary to deploy precious resources against the most viable targets.

The rewards of effective segmentation as part of an aggressive consumer activation program can be rich. A recent IRI study notes a comprehensive consumer activation program can deliver 5 percent to 10 percent growth for CPG firms, or $50 million to $100 million for a $1 billion brand.

To keep ahead of the curve, marketers need to build on their experience with segmentation and embrace micro-segmentation. Identifying and micro-targeting niche growth opportunities can help the data-savvy marketer leapfrog competitors to jump-start growth. It is important to remember that segments evolve slowly over a two- to three-year time frame, but underneath segments are micro-segments, within which trends evolve as quickly as six to eight months.

IRI believes micro-segmentation is worth the extra effort for manufacturers and retailers. The most efficient way to execute

The Art and Science of Segmentation

micro-segmentation strategies is often to incorporate them into an organization's existing CRM programs. This approach enables cross-platform synergies between CRM and in-store merchandising programs. Based on IRI analysis, incorporating effective micro-segmentation into consumer activation activities can increase ROI and reduce marketing waste considerably.

With all the advantages of segmentation come certain risks. While segments may exhibit homogenous behavior with respect to certain consumption categories, there could be a ton of diversity with respect to others—just like a Rubik's cube with just one face matched. Having a blanket segmentation strategy across entire portfolios of consumption categories will not be a viable strategy; need states vary by consumption categories, and so should the consumer segments.

Segmentation Strategies Should Align with the Consumer's Path to Purchase

It's optimal to undertake a multistep segmentation process to gain insights that will lead to the most effective shopper activation strategies.

A Multistep Segmentation Process can Reveal New Opportunities

With the proliferation of consumption channels and a fragmentation of media channels, segmentation has extended further down the consumer path to purchase to include audience segmentation and shopper/buyer segmentation. More importantly, the path to purchase starts with the consumers' self-identity; this predefines what their consumption preferences will be once they embark upon their need-fulfillment journey. Developing the optimal segmentation approach, avoiding common missteps and incorporating segmentation expertise from CPG and retail experts will help marketers maximize their ROI.

Marketers should begin a multistep segmentation strategy with an initial segmentation focused on identifying consumers. More permanent characteristics of consumer groups drive primary segmentation strategies. Demographic segmentation strategies have dominated marketing planning for a long time. Gender, age, income and ethnicity are typically dominant grouping factors for consumer behavior. Men or women within similar age groups, with similar disposable incomes, who also belong to similar ethnic backgrounds could have similar consumption behavior—although not always. Behavioral or psychographic segmentation (analysis of attitudes and interests and resultant lifestyles) fills in the remaining piece.

Marketers should base further segmentation on the results of primary segment-specific behavior. These can include:

- Need-state Segmentation: Identify consumers' needs
  - Need-state segmentation strategies focus on grouping consumers based on benefits or features that they are seeking. This strategy can include functional benefits like longevity/better health or emotional benefits like uniqueness/premium status or eco-friendliness.

The Art and Science of Segmentation

- Buyer Segmentation: Determine how consumers fill these needs now
  - How consumers go about fulfilling their needs drives buyer segments, including consumption channel segments (online versus offline buyers) and purchase behavior segments (heavy/medium/light and recency/frequency/monetary).
- Audience Segmentation: Understand how consumer investigate options
  - Marketers can base audience segments on differences in how consumers go about researching product options to fulfill their needs (passive search via exposure to mass media, active search via researching online or through word of mouth).

Determining and Executing a Viable Segmentation Strategy

A viable segment is one that has a common underserved need state and one that is large enough to offset the cost of marketing specifically to it. Steps to identifying a viable segment and beginning execution include:

- Gap Analysis: Gap analysis consists of identifying underserved segments. The gap marketers are trying to identify is between need states or benefit shares versus share of products serving those benefits or needs.
  - Opportunities for increased marketing lie behind products with lower shares, with features servicing need states aligned with proportionally larger consumer segment shares. Opportunities for innovation lie in white-space product features that either do not currently exist or combinations of features and benefits that shoppers within a segment require but that currently do not exist in a single product.
- Break-even Analysis for Segment Profitability: Once marketers identify an underserved segment, they need to determine if it's a viable segment to market to from a profitability perspective. Break-even analysis will tell them how much they need to sell of a particular product into a targeted segment for one year to break even from a marketing perspective. Marketers must make assumptions for fixed costs (production and mass media marketing) and variable costs (typically including promotion and variable production costs).

Break-even Point =

Total Fixed Costs /

(Selling Price - Variable Costs)

  - To address the issue of focusing on segments that are not currently profitable, but could become so later, marketers must augment the calculations above on segment profitability with an understanding of segment evolution, with consumption growth rates accounted for as segments evolve through life stages.

The Art and Science of Segmentation

- Marketing Budget Planning: Once marketers determine a viable segment to target, they need to determine an appropriate marketing budget. While there are sophisticated marketing optimization tools available, marketers can develop a raw estimate by taking into account the size of the segment they are targeting, segment media preferences and promotional sensitivity, as well as norms on how often they should communicate with consumers using specific levers.
  - While segmentation is valuable, marketers must be wary of segmenting too finely. Excessive segmenting can result in the law of diminishing returns. Marketing ROI suffers the more finely an audience is segmented, as economies of scale are lost—break-even analysis is a good tool to identify if you are slicing too thin.

Once marketers create an optimal budget plan, segmentation is complete, and the marketer moves into the activation phase, which is a topic for another IRI Point of View.

Micro-Segmentation can Achieve Macro Returns

The evolution from segmentation to micro-segmentation involves systematically leveraging consumer transaction-level data in a top-down manner to uncover hidden opportunities to increase growth at an actionable level. In this case, instead of the typical approach of drilling down to markets where a high-level opportunity or issue is identified, marketers can drill into the buying characteristics in that market to understand what particular aspect of purchase behavior is driving the issue or opportunity.

A McKinsey study has summed this up nicely: "Even consumer goods and services companies that have used segmentation for many years are beginning to deploy ever more sophisticated big data techniques, such as the real-time micro-segmentation of customers to target promotions and advertising." (Source: McKinsey Global Institute: "Big Data: The Next Frontier for Innovation, Competition and Productivity")

Segmentation Solutions in Action

Many leading CPG organizations are already leveraging advanced segmentation solutions and enjoying revenue and penetration benefits. Have a look at how other industry leaders are accelerating their companies' growth.

The Art and Science of Segmentation

Case Study

Segmentation Optimization Case Study

The C-level team at a Fortune 500 over-the-counter (OTC) healthcare company wanted to accelerate the growth of one of its brands that is already a market share leader and drives more than 70 percent of category consumption. However, standard marketing mix studies revealed that the market was saturated, with little or no potential for brand growth above current levels.

An IRI segmentation study of target consumers uncovered new information: Only about 65 percent of people exhibiting symptoms actually act on them; the remainder ignore their condition. Concurrently, the current ad campaign focused on consumers who were aware of their condition and seeking a product to alleviate it. The campaign did not attempt to educate people who might have the condition.

IRI recommended, and the manufacturer implemented, an advertising strategy that increased awareness of the condition and benefits of early treatment. As a result, the brand enjoyed consistent gains in market share over a two-year period, ultimately driving penetration up 10 percentage points, which translates to a $75 million sales increase.

Cross-Platform Segment Targeting Case Study

A large food manufacturer had a problem: Its brand was growing in smaller consumption segments, but lagging in key segments with significantly larger demographic bases. In some of these segments, the brand was under-indexing in its share of category penetration, while in other segments, it was losing out in purchase quantity (buy rate). Consumers were increasingly switching out of the brand.

Enter IRI. Its team developed marketing productivity models to understand the effects of offline/online media synergies for the brand over the past three years. IRI employed need-state principles to align marketing with a premium versus value tier product segmentation strategy. The team learned that while TV advertising was oversaturated, there was a significant ROI opportunity through creating synergies with digital platforms, especially social media and online video.

With new information in hand, the marketing team developed an updated plan that drove marketing investments up by $10 million. The improved reach and targeting led to a 2 percent increase in penetration across key product and consumer segments—breaking even in year two and achieving $60 million in incremental revenues by year three.

The Art and Science of Segmentation

IRI Segmentation Solutions

IRI's segmentation solutions enable CPG manufacturers and retailer decision makers to identify different groups of people (consumers, shoppers and customers) who share common attitudes and behaviors, creating comprehensive and powerful segments for highly efficient targeting.

IRI offers customized segmentation capabilities designed to help decision makers in a particular product or channel category address very specific issues, such as better understanding existing customer behaviors or attracting shoppers who substitute a different product for their company's product, which is the first step to developing a strategy to switch.

For issues that affect companies no matter what category or channel they serve, IRI also publishes syndicated segmentations. IRI's current syndicated segmentations include:

IRI EconoLink™
Recently updated to include the United Kingdom, France, Spain and Germany, in addition to the United States, this segmentation identifies six segments of each country's population based on their attitudes and actual behaviors as affected by their home economy.

IRI DigitaLink™
The trend toward an "always on" digital culture has driven the need for this segmentation, which explores five segments of the U.S. and European populations based on ownership and usage of digital devices (both mobile and stationary) and how these devices shape consumer lifestyles. Study results compare digital attitudes and usage behavior across those countries.

IRI MedProfiler™
Against the backdrop of a U.S. society where significant portions of the population are overweight or obese, MedProfiler identifies seven segments of the population based on health concerns and conditions, lifestyles and dieting.

IRI NutriLink™
This segmentation focuses on key trends in eating behavior and identifies six distinct market segments in the U.S. and explores their attitudes and actions.

IRI SilverLink™
Shoppers over 50 continue to dramatically affect the economies of many countries and enjoy outsized market power. SilverLink segments the older populations in the U.S. based on attitudes, habits, lifestyle and abilities.

SPINS NaturaLink™
This segmentation analyzes the total U.S. population, not simply users of natural/organic/eco-friendly products. It is co-developed by IRI and SPINS, a leading provider of retail consumer insights for the natural, organic and specialty products industry.

The Art and Science of Segmentation

About the Authors

Joy Joseph leads the Marketing Productivity practice and is a member of the IRI Strategic Analytics leadership team. He is based in the Norwalk, CT office. You may contact him by email at Joy.Joseph@IRIworldwide.com.

Carl Edstorm leads the Survey Solutions practice and is a member of the IRI Consumer and Shopper Marketing leadership team. He is based in the Chicago office. You may contact him by email at Carl.Edstrom@IRIworldwide.com.

About IRI. IRI is a leader in delivering powerful market and shopper information, predictive analysis and the foresight that leads to action. We go beyond the data to ignite extraordinary growth for our clients in the CPG, retail and over-the-counter healthcare industries by pinpointing what matters and illuminating how it can impact their businesses across sales and marketing. Move your business forward at **IRIworldwide.com**

Corporate Headquarters: 150 North Clinton St., Chicago, IL 60661, USA, (312) 726-1221