strategy+business

ISSUE 65 WINTER 2011

Making Customer Segmentation Deliver

As the ability to gather sophisticated data grows, here's a four-step process for making segmentation drive improved performance.

BY COREY YULINSKY

REPRINT 11401

This article was originally published by Booz & Company.

pwc | strategy&
Formerly Booz & Company

Making Customer Segmentation Deliver

As the ability to gather sophisticated data grows, here's a four-step process for making segmentation drive improved performance.

by Corey Yulinsky

Few phrases have as much currency in today's business-to-consumer (B2C) companies as *the customer-centric organization*. Although the particulars vary widely, most companies pursuing customer-centricity rely on some form of market segmentation. Segmentation provides insight into customer behavior, habits, and preferences, increasing the odds of success in marketing and experience management campaigns, and driving brand positioning and product development. For transaction-intensive industries, such as the airline, credit card, retail banking, retail, and telecommunications and wireless sectors, customer segmentation has become a critical capability in using the growing volumes of data on individual customer behavior to develop and implement successful go-to-market strategies.

More B2C companies are striving to build customer-centric businesses, but will they be able to derive real value from their effort? A handful of companies — such as Charles Schwab in investments, Capital One in credit cards, and Caesars Entertainment in gaming — have had well-documented success. But other data-intensive companies feel their segmentation efforts have failed to deliver anything near the level of benefit they should. Even as they collect more information than ever before, these companies struggle with applying the insights afforded by segmentation to drive change and performance improvement.

This paradox — that companies with the most data about their customers find it most difficult to use it — is likely to become more widespread as the digital transformation continues. Too often, companies develop segmentations that are based on conflicting business objectives, are not broadly understood or shared, or cannot be readily acted upon. Top managers must realize that a segment-based model requires rigorous execution. It will succeed only if it is embedded in the company's overall strategy, crosses the boundaries of all business units and functional departments, and produces clear and actionable guidance.

Companies that have implemented segmentation successfully tend to use it as a strategic context in designing their business models, as a touchstone for branding and value proposition development, and to guide processes such as customer acquisition and retention. Crucially, they know how to manage the complexity that segmentation inevitably introduces to an organization, and how to capitalize on the insights it provides.

We advise companies to take a four-step approach to segmentation: define the objectives of segmentation clearly, design the segmentation around those objectives, prepare a blueprint of the effects of the segmentation across the entire company's decision processes, and carefully manage the necessary changes that segmentation will demand of the organization. The goal is to ensure that segmentation leads to well-defined processes and actions that improve performance.

1. Define the objectives clearly. The most important question for each company to ask: What is the purpose of segmentation? Understanding the purpose will enable decision makers to determine whether the segmentation effort is strategic, tactical, or both.

Strategic segmentation is used for broad, enterprise-wide purposes — operating model design, branded customer experience, and overall value proposition development. It often becomes the basis for the design of the organization. Charles Schwab's approach to segmenting investors by assets and desired relationship support level is one example. Many retail banks group their customers into income or asset classes such as affluent, mass affluent, and mass market, and others combine these classifications with insights relating to behaviors and channel usage.

Tactical segmentation is used for a much more specific purpose, such as new customer acquisition, an upselling campaign, or channel migration. Among the successful implementers, the tactical segments map to the strategic segments in an explicit way. In fact, combining the strategic and tactical segments in campaign modeling produces substantial uplift; one bank was able to triple the profitability of a home equity line of credit (HELOC) cross-selling campaign by tailoring its HELOC acquisition model and offer to a specific strategic segment. The notion of "horses for courses" — designing the segmentation around the specific business purpose — is apt here. Understand clearly which decision processes will be affected and which business partners need to be involved.

2. Design around the objectives. The key to effective design is working back from the business decisions that need to be made. Once the objectives have been determined, the segmentation research itself must be rigorously designed to reflect them, and to ensure that the results will be *insightful* (they will tell us things we do not already know about customer behavior and needs), *actionable* (they will identify levers that will move behavior), and *identifiable* (they will be able to tag individual customers in the database with reliable segment membership). This implies that multiple dimensions — behaviors, attitudes, demographics, channel use and preferences, and profitability — must be incorporated to develop a full picture.

In the past, difficult choices had to be made about which one or two dimensions drove segmentations, leading to, for example, heavily attitudinal segments that could not be identified or heavily behavioral segments that provided no insight into the causes of behaviors or the ways to influence them. New methodologies, such as the statistical modeling technique of latent class analysis, allow the synthesis of these different types of data — for example, transactional data, survey data, continuous variables, and discrete variables — into the same segmentation model. If designed properly, these methodologies yield identifiable segments that can be used to pursue new opportunities. Common examples include fast-food chains identifying their frequent users and wireless companies looking for "data hogs" who consume inordinate amounts of bandwidth. More sophisticated companies, such as some high-end retailers, add aspirational desires to the behavioral mix to identify and attract consumers who lust for the latest brand as soon as (or before) it

hits the shelves.

One detail to consider is how to approach customer profitability. Some companies use profitability-based segmentation, others incorporate profitability into the segmentation as a dimension, and still others use it as a criterion for choosing among potential segmentations based on their ability to discriminate among profitable customers. Each has its benefits and costs, but it is important to recognize that a pure profit segmentation may not be very actionable, because in some industries, such as financial services, there are multiple routes to profitability.

3. Prepare a blueprint to operationalize the segmentation. Begin to map out the decision processes by considering these questions: How is segmentation going to be used to influence the major value levers in your business? Will it underpin a redesign of the brand and the value proposition or of frontline sales and service? Will it ultimately result in more tailored and dynamic online and direct marketing? How are the business and functional units responsible going to access the information and use it on a day-to-day basis?

As soon as the outline of the segmentation permits, begin to define these process changes, share them with affected business partners, and formulate and discuss revised metrics that reflect the new capabilities. For instance, it is essential to work with the front line to define how it will modify today's sales and service protocols to incorporate greater customer knowledge and targeted pitches. One large bank linked its strategic segments to targeted lead lists focused on explicit behaviors — cross-sell leads, at-risk/retention leads, and acquisition leads — and instituted a new and more powerful sales pipeline management discipline.

In another example, a major retailer redesigned the location, configuration, and staffing of its fitting rooms based on a target segment view of the customer's journey through the store. It is necessary to craft practical methods of delivering the required segmentation results that effectively conceal their analytic complexity from customer-facing staff, thus enabling productive face-to-face interactions with customers in real time.

Subtle timing must be managed: Business partners need to be engaged and prepared in advance, but not so far in advance that requi-

Illustration by Heads of State

site changes are too theoretical or abstract. For executives at brokerages, for example, communicating the message that "We need to talk to segment X about 529s and Roths in the context of their families" is much more meaningful than "We need to be more segmented in how we are going to market." Building on what's tangible helps in configuring informed decision processes.

the tools these teams will be provided to let them do so — has often proved a very powerful way to build buy-in and execution. This is usually best done by a combination of senior executives and field leaders on-site in stores and branches on a regular basis, serving as coaches and exemplars.

At a time of increasing competition and the rise of new methods to capture immense amounts of data about customers, every company must raise its ability to anticipate and respond to customer needs and wants. Segmentation will be essential to the process of managing the complexity of continually evolving and fragmenting customer groups and their different demands. Creation of a company-wide operating model that can convert this flood of data to useful information in order to make better go-to-market decisions will be critical. Companies that achieve this will have a substantial advantage in making *customer-centricity* more than a slogan. +

Segmentation is more of a change management challenge than a technical or marketing challenge.

4. Manage the implementation process. Making segmentation deliver is ultimately more of a change management challenge than a technical or marketing challenge, but this point tends to be overlooked. The tools for managing change — targeted and tailored communications, sequenced to engender understanding, engagement, and acceptance — need to be deployed fully. Expectations must be managed from the start; too often these efforts begin with a "big bang" orientation that misstates the nature of the change required to capture the performance benefits of segmentation.

Most important, of course, is for leaders to lay out the business case for moving to a more segment-focused set of processes. When employees ask, "What do you want me to do differently and why?" and "What's in it for me?" leaders who respond with a clear message will dramatically enhance progress. In particular, painting a clear picture of how a segment-based strategy will enable frontline teams to deliver better customer experiences — and of

Reprint No. 11401

Corey Yulinsky
corey.yulinsky@booz.com
is a partner with Booz & Company based in New York. He has advised multiple leading providers of consumer financial services on customer-driven growth, analytics and capabilities development, and revenue improvement issues.

strategy+business magazine
is published by PwC Strategy& Inc.
To subscribe, visit strategy-business.com
or call 1-855-869-4862.

For more information about Strategy&,
visit www.strategyand.pwc.com

• strategy-business.com
• facebook.com/strategybusiness
• http://twitter.com/stratandbiz
101 Park Ave., 18th Floor, New York, NY 10178

pwc | strategy&
Formerly Booz & Company