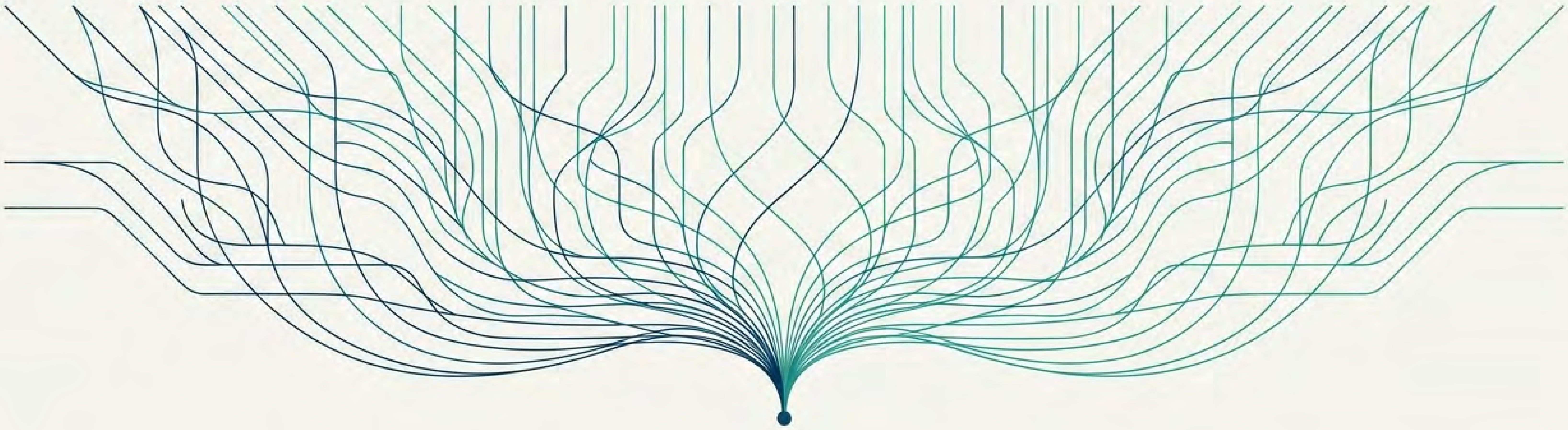
Rethinking Customer Segmentation: It’s Not Where You Start

A strategic framework for identifying the right customers and reaching them effectively.



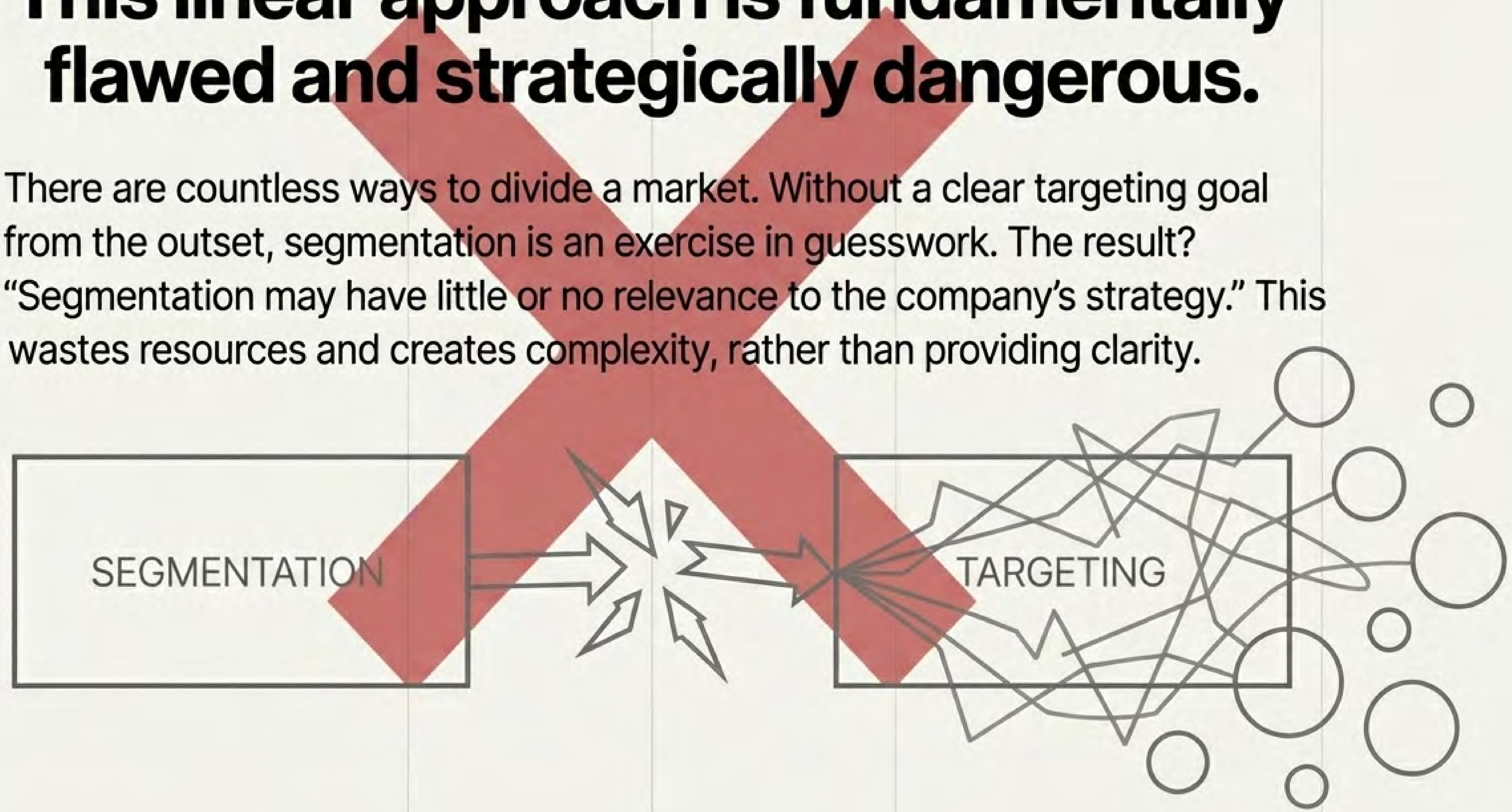
The common wisdom on finding customers is a simple, linear path.

Most marketers are taught a sequential process:

1. Segment the Market: Divide all potential customers into distinct groups.
2. Target a Segment: Choose which of these groups to pursue.

This linear approach is fundamentally flawed and strategically dangerous.

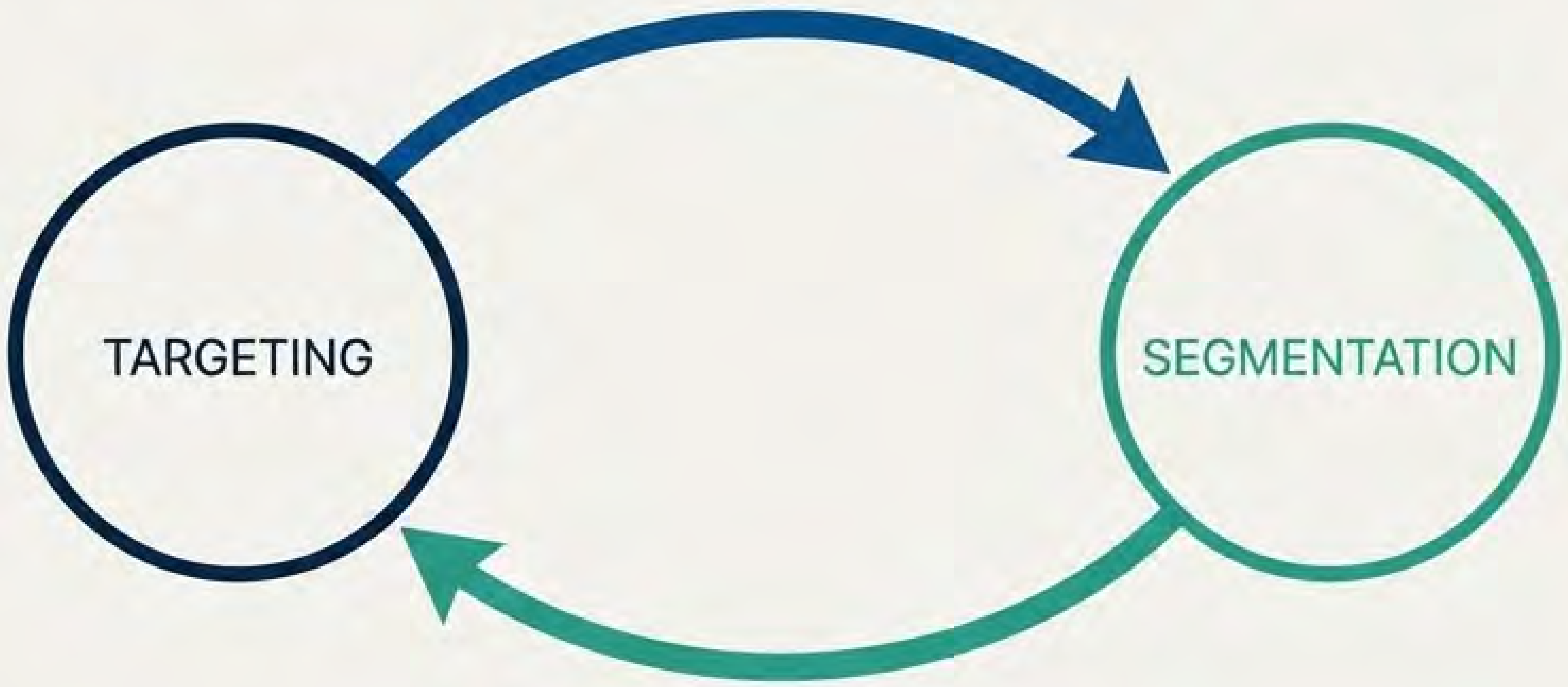
There are countless ways to divide a market. Without a clear targeting goal from the outset, segmentation is an exercise in guesswork. The result? “Segmentation may have little or no relevance to the company’s strategy.” This wastes resources and creates complexity, rather than providing clarity.



The solution is to treat segmentation and targeting as an iterative, integrated process.

Segmentation does not precede targeting; it serves it. For segmentation to be relevant, customer segments must be defined in a way that facilitates targeting.

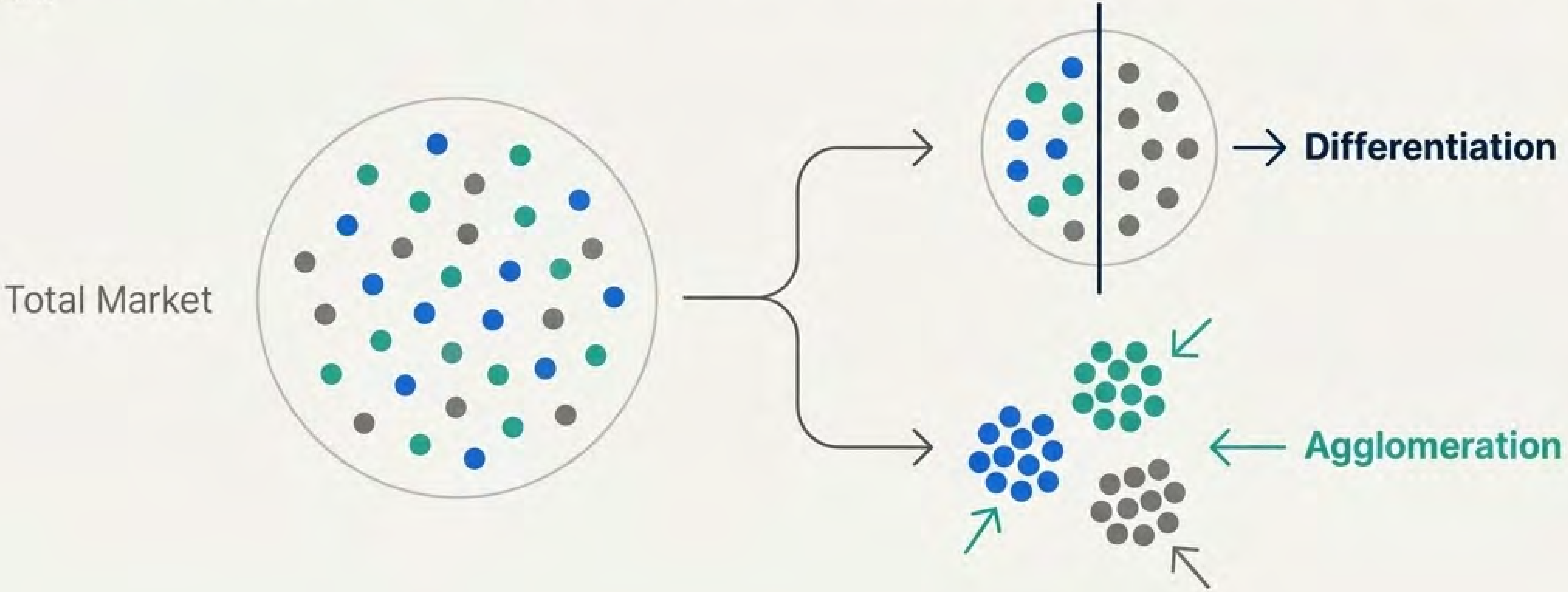
This requires a general understanding of who your target customers might be and the value you can offer *before* you begin segmenting the market.



Segmentation itself is a balance of two opposing, complementary forces.

Every act of segmentation involves two processes working toward the same goal: creating distinct, homogeneous groups.

* **Differentiation**: Dividing all buyers in the market into groups by emphasizing *differences* in their needs and resources.
* **Agglomeration**: Grouping individual buyers into segments by highlighting *similarities* in their needs and resources.



An effective segmentation framework operates on two distinct levels: strategic and tactical.

These two levels address the two fundamental questions of targeting: WHO to serve, and HOW to reach them.

STRATEGIC

Groups customers based on the *value* you can create for them and capture from them. It is about their *needs*.

TACTICAL

Groups customers based on their *profile* characteristics. It is about the *channels* to reach them.

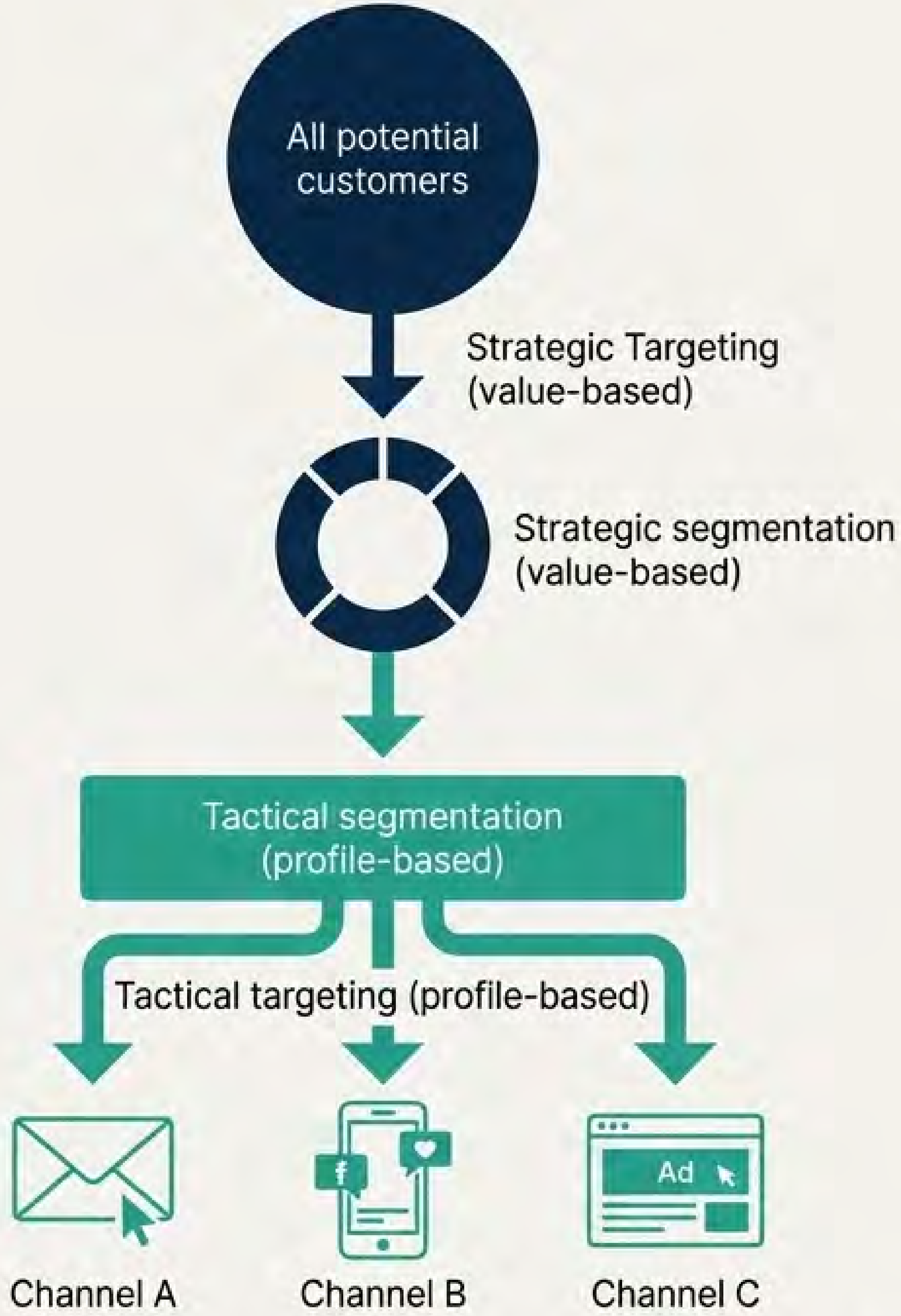
The process begins with Strategic Targeting, which is driven by value.

The first and most critical decision is strategic: identifying a customer need that the company can fulfill better than its competitors, in a way that creates value for the company.

This decision is supported by **Strategic (Value-Based) Segmentation**, which groups customers according to their needs and the value they can generate.

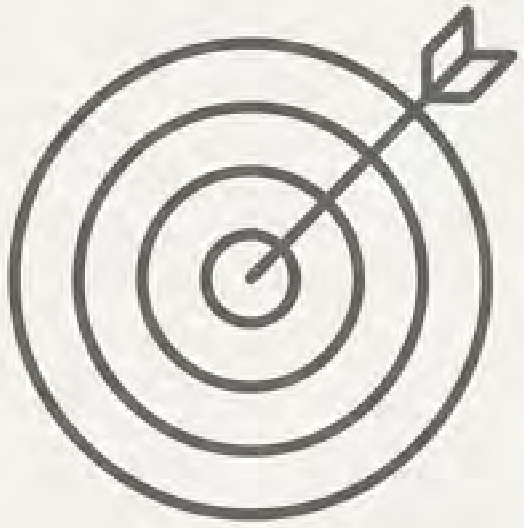
Tactical Targeting then identifies the channels to reach your strategic segment.

Once the strategically viable segment is selected, the next step is to identify the most effective and cost-efficient channels to reach them. This is guided by Tactical (Profile-Based) Segmentation, which defines the demographic, geographic, behavioral, and psychographic profiles of the chosen customers.



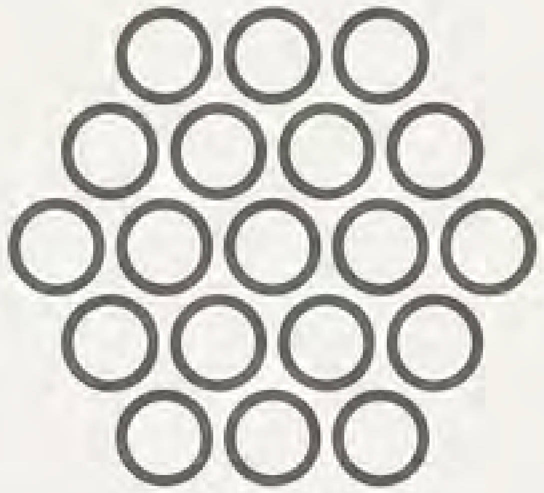
Three core principles ensure your segmentation is powerful and effective.

To be effective, any segmentation effort—strategic or tactical—must conform to three main principles.



Relevance

It must group customers based on their likely response to your offering.



Similarity

Customers within a segment must share similar, homogeneous preferences.

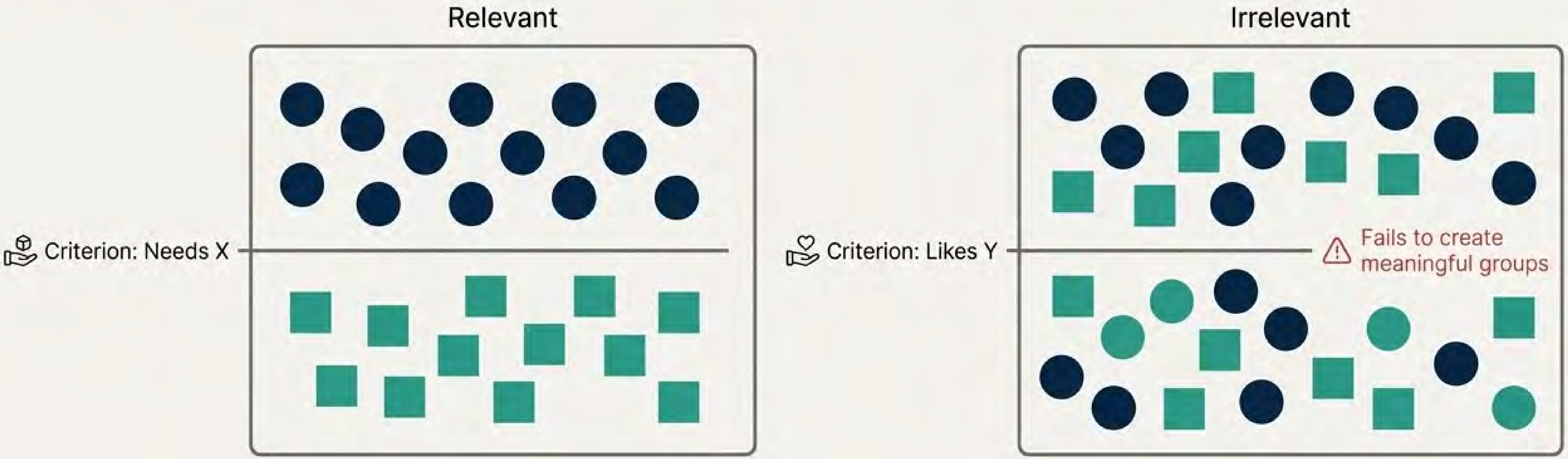
Comprehensiveness

It must include all potential customers in the market.

Principle 1: Relevance ensures segmentation facilitates, not complicates, your strategy

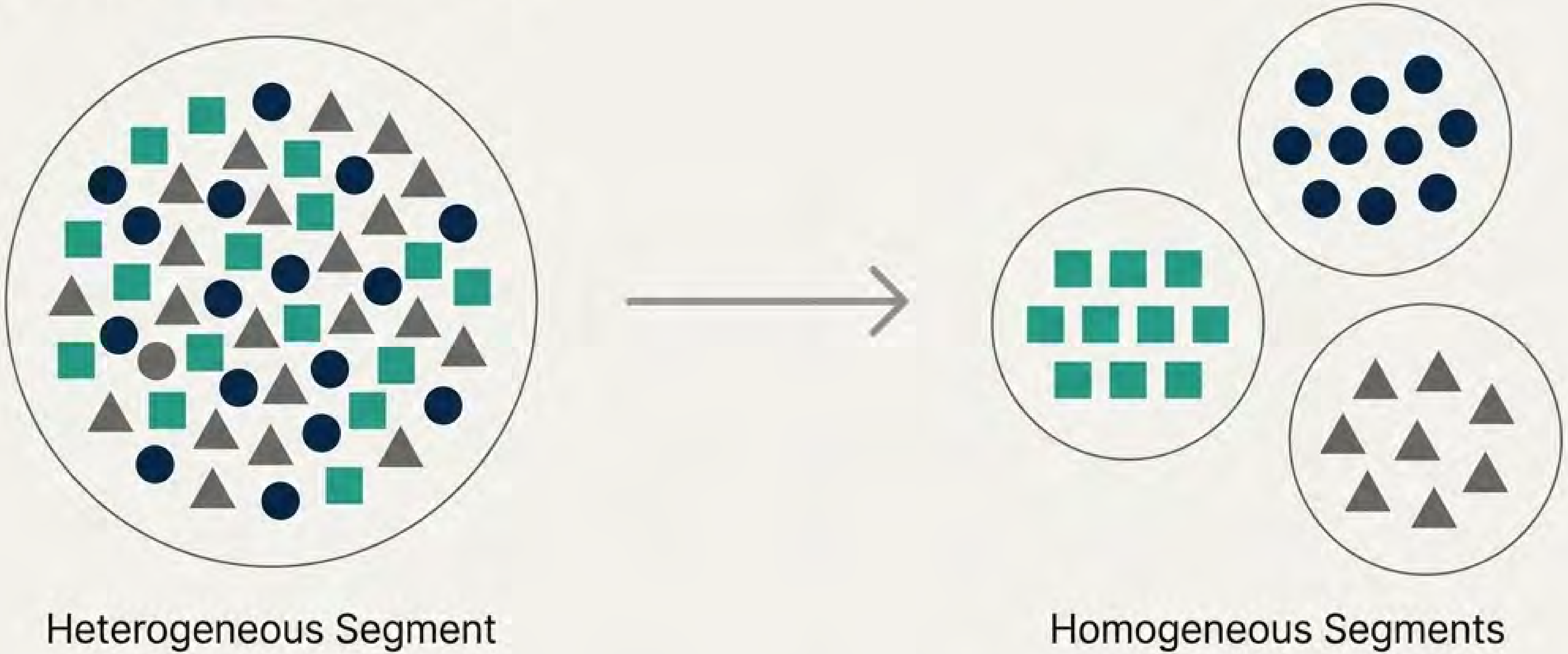
Segmentation criteria must be directly linked to the factors underlying your company's targeting strategy. While there are countless ways to divide customers, many are simply irrelevant to how they will respond to your offering.

“Segmenting markets without a clear targeting purpose in mind often wastes resources and complicates managerial decision making instead of aiding it.”



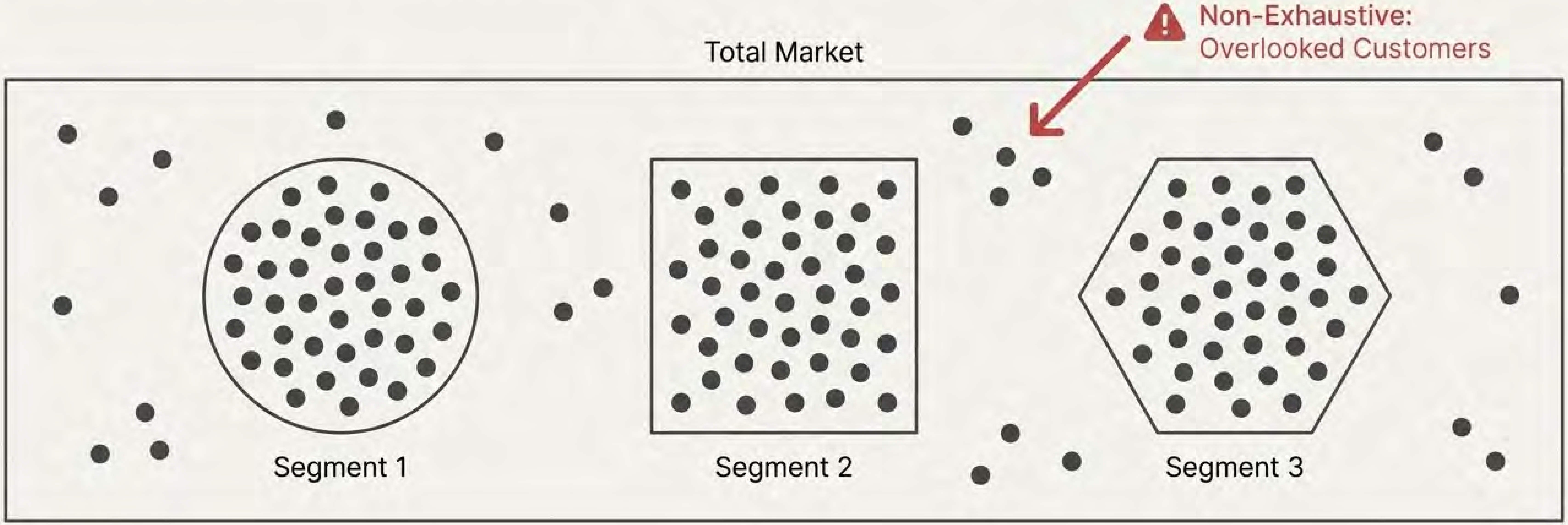
Principle 2: Similarity creates homogeneous segments that respond uniformly.

The goal of segmentation is to group customers so that those within each segment share similar preferences and are likely to respond to the company's offering in the same way. This requires a balance. More granular segmentation leads to greater homogeneity but also requires more customized offerings and can lead to unnecessary fragmentation.



Principle 3: Comprehensiveness ensures no potential customer is overlooked

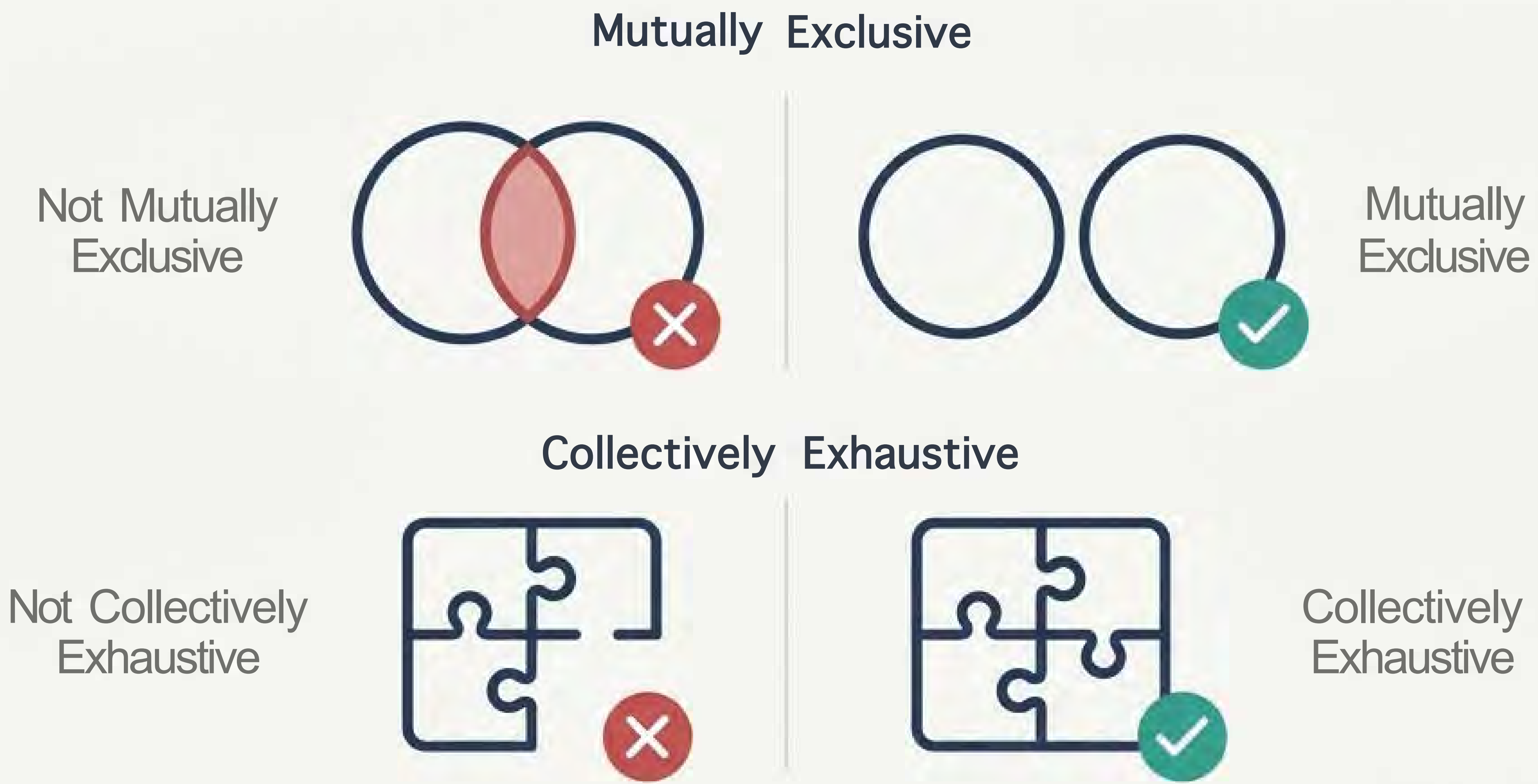
An effective segmentation scheme must be collectively exhaustive, encompassing all potential customers in the market. Every customer should be assigned to a segment. Excluding any subset of the market means you cannot consider them when identifying viable target segments, potentially leaving value on the table.



A simple way to remember the principles: The MECE rule.

The core principles can be simplified into the MECE rule, which states that segments must be:

- **Mutually Exclusive:** Segments are distinct and do not overlap. This aligns with the principle of **Similarity.**
- **Collectively Exhaustive:** All potential customers in the market are included. This aligns with the principle of **Comprehensiveness.**



In practice: How a credit card company can violate all three principles.

Scenario: A company offers a credit card that rewards customers with airline miles.

Irrelevant Segmentation

Segmenting potential customers based on their *favorite type of cuisine.* This criterion is not connected to their interest in air travel.

Heterogeneous Segmentation

Segmenting based on a *general interest in travel.* This is too broad and groups together people who want miles with a specific airline and those who don't.

Non-Exhaustive Segmentation

18-35

Limiting the focus to customers *aged 18 to 35.* This excludes many other potential customers who travel and would value the card.

Stop segmenting in a vacuum. Start with strategy.

Effective customer identification is not a linear checklist. It is an integrated framework where strategic goals actively shape the segmentation process. By focusing on value first (strategic) and profiles second (tactical), you ensure your efforts are always relevant, efficient, and powerful.

The Flawed Approach

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The Strategic Framework