

Customer Segmentation in 5 Questions

What is customer segmentation?

Customer segmentation is the practice of dividing a company's customers into groups relevant to the particular business. It is grouping customers in a way that, each group members should be similar to each other in demographic, behavioral or psychographic aspects. This grouping is done to deliver relevant and specific offers, promotions or information to the customer, yet to keep the complexity at a certain level that would not exhaust the CRM unit of the company.



Nowadays every customer expects a special care and solution to his/her needs. Therefore winning the loyalty of each customer passes from the right communication of offers, promotions and even advertising. When you have 50 customers, it may sound easy to do; yet if you have millions, categorizing customers using segmentation is a life saver.

How is it done?

Customer segmentation is based on customer data; therefore metrics to be considered in segmentation are subjected to change for every industry drastically and for every company slightly. There are a few common segmentation approaches for any industry:

- **Demographic:** Companies can always segment customers by their static and product unrelated metrics such as gender, age, marital status, address, and level of education. As an example, 25-38 years old married man can be a segment and it can be referred as "married middle age men".
- **Behavioral:** In some industries actions related to product or service use is kept in a database, behavioral segmentation can be a solution to classify customers. As an example, in Pay TV industry; customers tend to watch a certain soccer team's game and not the other, can be classified as that teams "fans", or customers are buying movies right after they are available can be classified as "movie lovers". On the other hand in banking, all transactions are recorded and customers can be grouped by the transaction types they do the most.
- **Benefit:** It is grouping the customers by examining what they seek while purchasing company's product or service. A very good example would be grouping members of a gym as "weight loss" or "muscle gain".
- **Psychographic:** It is usually harder to define a customer's character or lifestyle; yet if company has the sufficient data psychographic grouping can result very effective targeting. Examples could be the socio-economic segments like "A, B, C1, C2" and so on.
- **Profitability:** Also it is commonly used by companies to group customers by the amount of profit they contribute to the company. Such segments could be named as "high profit", "growth potential" or "loss causers".

Although above list is a set of commonly used basic segments, when it comes to the segmentation for a company which has sufficient data to do a more detailed grouping more than one dimension can be considered. This means that all the customers have more than one segment based on different group of metrics. At projects of credit card customer segmentation, our team members define segments using two different dimensions both based on behavioral

metrics: use of credit card (revolving, cash advance, installments...) and kinds of purchases made by using credit card (electronics, fuel, grocery...). So; for example, a customer can be a member of “installment” and “grocery” at the same time.

What does it take?

Customer data is like field with fertile soil; full of potential and ready to be home for variety of plants. But choosing right crops, planting and feeding them; takes right people, techniques and maintenance.

Experts: Building customer segments is a very demanding job, and the most crucial component is the human resource for sure. Analysts who will do the segmentation have to be equipped with technical skills and the relevant business mind set; while looking through millions of customer data he or she has to make quick decisions about relevance, cut-off points and metrics to be used of data. Technical skills are enabling analyst to walk through data however business mind set is the map of the segmentation journey. Without the right experts, customer segmentation projects are destined to fail.

Tool: Segmentation can be done by many tools, however depending on the metrics to be used or operation type (real-time, batch...) there may be better choices than others. Even though tool is the essential part of a customer segmentation project, there is no right answer to the question of which tool to use. The tool that experts can work efficiently with is usually the right tool.

Clean and sufficient data: Customer databases are usually structured carefully by database admins and goes through maintenance regularly. But even after all the effort shown; data can still be “dirty”. Another issue that makes segmentation projects tougher; is insufficient data. Company may have enough number of customers in its database, usually the fields to be used for segmentation has “null” or unstructured values, which have no use. During a recent project done at a human resources firm; project has started with 3.7 million users, due to insufficient data project was resumed on 3 million users only, and 700.000 of them had at least one field that required format editing. Our comment about that certain database was; “it is one of the cleanest databases we have ever worked on”.

How to use segments?

After planting, plowing and watering the field filled with plants; here comes the time to harvest the fruits. When a company has all the customer segments developed, then it will be time to convert all that work in profits or customer satisfaction and in some cases, both. Needs of the customer group and actions to be taken has to be defined for each segment developed, in all following dimensions (called 4P); product, place, promotion, price.

For example 4P of the credit card segment “cash advance” are:

Product: Cash advance is the product that drives this segment; therefore these customers can probably be attracted to short term consumer loan and it is the product that bank wants to sell.

Place: Cash advance is obtained via ATMs and so it will be the right channel to offer the new product from. Since ATMs are often visited by the customers in the segment and also the new product can be delivered through this channel.

Promotion: Promotion is about how to do the communication of the product desired to be sold. So the communication of the short term consumer loan product is normally focused on necessity of cash but for this segment should have a different focus than usual. A sub-group of customers from this segment, would be likely to prefer larger balance with lower interest rate than cash advance.

Price: Short term consumer loan should have a lower interest rate than cash advance, so that it makes sense to buy for the customers of the segment. This segment is already buying a loan for a high interest rate, so there is no need of having very low interest rate in order to make profit.

The right choice of 4P relevant to each segment is the strategy to convert segmentation to profit.

What are the risks?

Customer segmentation is about grouping the customers and serving them accordingly. Each segment has a unique set of 4P. If the grouping is done wrong, the right combination of 4P doesn't have any importance at all.

Here is an example of the events that have occurred in the cases of wrong or insufficient segmentation:

As the result of a customer segmentation done at a bank only by considering the volume of assets owned credit cards were going to be offered to each customer. Credit cards had 3 different types and each type is for a different segment. While the offers were being made, there was one customer who had been offered a platinum card later was revealed as the pupil of a panel beater ("kaportacı" in Turkish). His employer kept all his cash on one of his accounts yet he originally had a joint credit card to his employer's. If the metric of owning the main credit card was added to segmentation, outliers like mentioned above would be eliminated.

In a nutshell...

Customer segmentation is a simplified way to exhibit special care and communication to a company's customers, however it is only useful when combined with good set of actions (CRM or marketing). It is a very delicate subject that can help generate profit, but if done or used wrong, it can also lead to losing customers or their loyalty.