

Defining customer segmentations based on how clients think

by **Dr Claude Diderich** | innovate.d, Switzerland

Customer segmentation is a key business tool, not only in marketing. It contributes to the efficiency and effectiveness of a firm by grouping customers who exhibit common traits and are therefore expected to have similar needs. Different industries and distinct market positioning require specific customer segment definitions. When focusing on the service industries, customer segments should relate to how customers think and define trust.

The concept of customer segmentation made its market entry in the mid-1950s through pioneering work by Smith and a group around Alderson. An imposing body of formal, rigorous, and normative concepts has been developed since then. Nowadays, good customer segmentation is at the heart of any successful business strategy. Customer segments are one of the nine building blocks in the *Business Model Canvas* of Osterwalder and Pigneur. They support:

- understanding customers and creating segments regrouping consumers with common traits, and
- offering products and services that match the needs of consumers with common traits.

The core assumption behind customer segmentation is that consumers with shared traits have similar needs. Furthermore, it supports efficient and effective business processes when holistically considering the whole value chain, rather than focusing only on marketing aspects.

APPROACHING CUSTOMER SEGMENTATION

There exist five categories of traits typically used to define customer segments. These include *demographic* (e.g., age, gender, occupation), *geographic* (e.g., ZIP code, location density, accessibility), *psychographic* (e.g., personality, lifestyle, social standing), *behavioral* (e.g., purchasing behavior, buyer journey, loyalty), and *financial* (e.g., wealth, income, share of wallet). If one looks closely at these classification schemes, they relate to customer traits that are independent of the product or service that a firm wants to sell. The basic assumption, which turns out often not to be true, is to assume that customers with shared traits have similar needs, or, as Christensen said, have similar jobs-to-be-done.

The concept of *persona*, pioneered by Alan Cooper in the 1980s, is a fictional description of a real customer. It has been developed to overcome some of the drawbacks of traditional customer segmentation. It allows a better understanding of who customers really are. This is important as Herbert Joly, former CEO of BestBuy, wrote, “Focusing on customers is what underpins sustainable success.” Statistics have shown that getting customer segments right and aligning marketing activities with them can increase conversion rates by more than 20% in typical cases, sometimes even significantly more.

CUSTOMER SEGMENTATION IN SERVICE INDUSTRIES

There does not exist one single approach to customer segmentation that always works. Different offerings require different strategies. But they all share a common trait—they relate customer segments to products and services that meet the respective customer needs.

Focusing on trust as the primary customer need

There is something unique about the service industry. Services cannot be touched or assessed before being bought. It is, for example, impossible to judge the quality of an airline if you have never flown with it. A private banking customer must trust their adviser when signing up for a discretionary mandate to manage their wealth. This means that a key attribute relating customers to the services at hand is trust. Therefore, a sound approach to customer segmentation is to create segments based on how customers define, understand, and evaluate trust. Trust is an emotional attribute that can be related to by speaking a common language. If the person selling a service speaks the same language, metaphorically speaking, as the customer, this forms the basis of trust.

Thinking like customers

Only building trust with customers and speaking their language is insufficient. Firms must also mentally “be” their customers. To achieve that goal, firms must move from a business model focused on transactions and selling services to a business model that solves customer problems, addresses their needs, and builds lasting relationships.

Relationship managers—the new term for sales professionals—must see eye-to-eye with customers. Think about the challenge of a 30-year-old MBA graduate having to build trust with a 70-year-old privateer, even if the graduate is an expert in financial products; or a Ph.D. servicing a self-made entrepreneur who has never attended college.

Relationship managers must be customer experts rather than service experts, leading to creating customer segmentations based on customer expertise and how customers think. Only by diving into the mindset of customers can firms identify commonalities that allow to offer better services. Consider a farmer who wants to extend their cow barn and needs a loan. Only by understanding how running a cow business works can a banker structure the loan in the most appropriate way for the farmer. The specificities of how loans work and how the bank manages them become second in the discussion with the farmer.

LESSONS LEARNED

When developing customer segments in service industries, trust plays a key role. Defining customer segments based on trust can be achieved by focusing on regrouping customers who speak the same language, figuratively, and share a common line of thinking about what their needs are and how they want them to be addressed. Focusing first on what’s in it for the customer, before turning to what’s in it for the firm, is central.

Successful firms follow the mantra:

Profit is the outcome, relationship the core!

in their customer segmentation approach.



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