Business Marketing Management: B2B 11e

Michael D. Hutt & Thomas W. Speh

Chapter 4:

Segmenting the Business Market and Estimating Segment Demand

Chapter Topics

- Benefits of and requirements for segmenting the business market
- Potential bases for segmenting the business market
- Procedure for evaluating and selecting market segments
- Role of market segmentation in the development of business marketing strategy
- Process for estimating demand in each market segment
- Specific techniques to effectively develop a forecast of demand

Knowing the Customer is Not Enough!

- Once we know the customer, we need to understand what new products, services and features will excite them.

- Our job is to know the customer so well that we can provide him or her with (technological) solutions to problems that they don't even know exist yet!

High-Growth Companies Succeed By:

- **Selecting well-defined groups of potentially profitable customers**

- **Developing distinctive value propositions that competitively meet customer needs**

- **Focusing marketing resources on acquiring, developing, and retaining profitable customers**

Business Sector

- The business market consists of 3 broad sectors:
  1. Commercial Enterprises
  2. Institutions
  3. Government

- Each sector has many segments
- Each segment has a unique need and requires a unique marketing strategy

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Keys to Success

The marketer who…

a. Recognizes various profitable segments
b. Develops competitive products or services
c. Develops a marketing program to take advantage of opportunities B2B groups offer

…can be very successful!

What Is A Market?

A market is…

(1) People or organizations who
(2) need & want what we offer (all have the same problem and need a similar solution)
(3) have the ability to purchase and
(4) the willingness to buy ASAP.

A group of people that lacks any one of these characteristics is not a market.

Market Segmentation

Market	**People or organizations with needs or wants, the ability to purchase and the willingness to buy.**
Market Segment	**A group of present or potential customers with some common characteristics which we can explain (predict) their actions when subjected to marketing stimuli.**
Market Segmentation	**The process of dividing a market into meaningful, relatively similar and identifiable segments or groups.**

Business Market

- Often in the business market, segments that appear strong (that is, they produce a lot of volume) often do not contribute as much to profits as they should.

- Because of this, it is important to choose business market segments wisely.

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What key criteria best define a unique market segment?

- Measurability
- Accessibility
- Substantiality
- Responsiveness

1. Measurability

The degree to which information on particular buyer characteristics exists or can be obtained.

2. Accessibility

The degree to which the firm can effectively focus its marketing efforts on chosen segments.

3. Substantiality

The degree to which the segments are large or profitable enough to be worth considering for separate market cultivation.

4. Responsiveness

The degree to which segments respond differently to different marketing mix elements such as pricing or product features.

Art of Segmentation

Segmentation involves identifying groups of **customers** or **business groups** that are…

1. Large enough
2. Unique enough
3. Financially independent enough
4. Reachable enough

…to justify a separate marketing strategy.

Marketer’s Dilemma

- Marketing strategists spend too much attention on “What is..” vs. “What could be…”
- By focusing only on existing markets, strategists may:
  - Ignore new markets
  - Miss signals about emerging new markets
  - Miss signals about new opportunities
- To spot new opportunities, marketers should focus on the following three customer groups…

Missed Opportunities – Three Customer Groups

1. **Undershot customers - Existing solutions fail to meet their needs, resulting in:**
   a. **a purchase of new product versions**
   b. **at steady or increasing prices.**

2. **Over Shot Customers - Existing solutions are too good, thus customer is reluctant to purchase new version.**

3. **Non-Consuming Customers – Customers who lack resources, skills or ability to benefit from existing solutions.**

Missed Opportunities (continued)

- **Often, marketers focus too much on Undershot and not enough on Overshot or Non-Consuming customers.**
- **Consequently, marketers miss opportunities to:**
  - **Recognize new innovations that could motivate Overshot and Non-Consumers to buy.**
  - **Invent new products that could revolutionize industries as we know it.**

Examples:

Computer industry – Mainframes vs. PCs

Printing Industry – Print shops vs. office printers

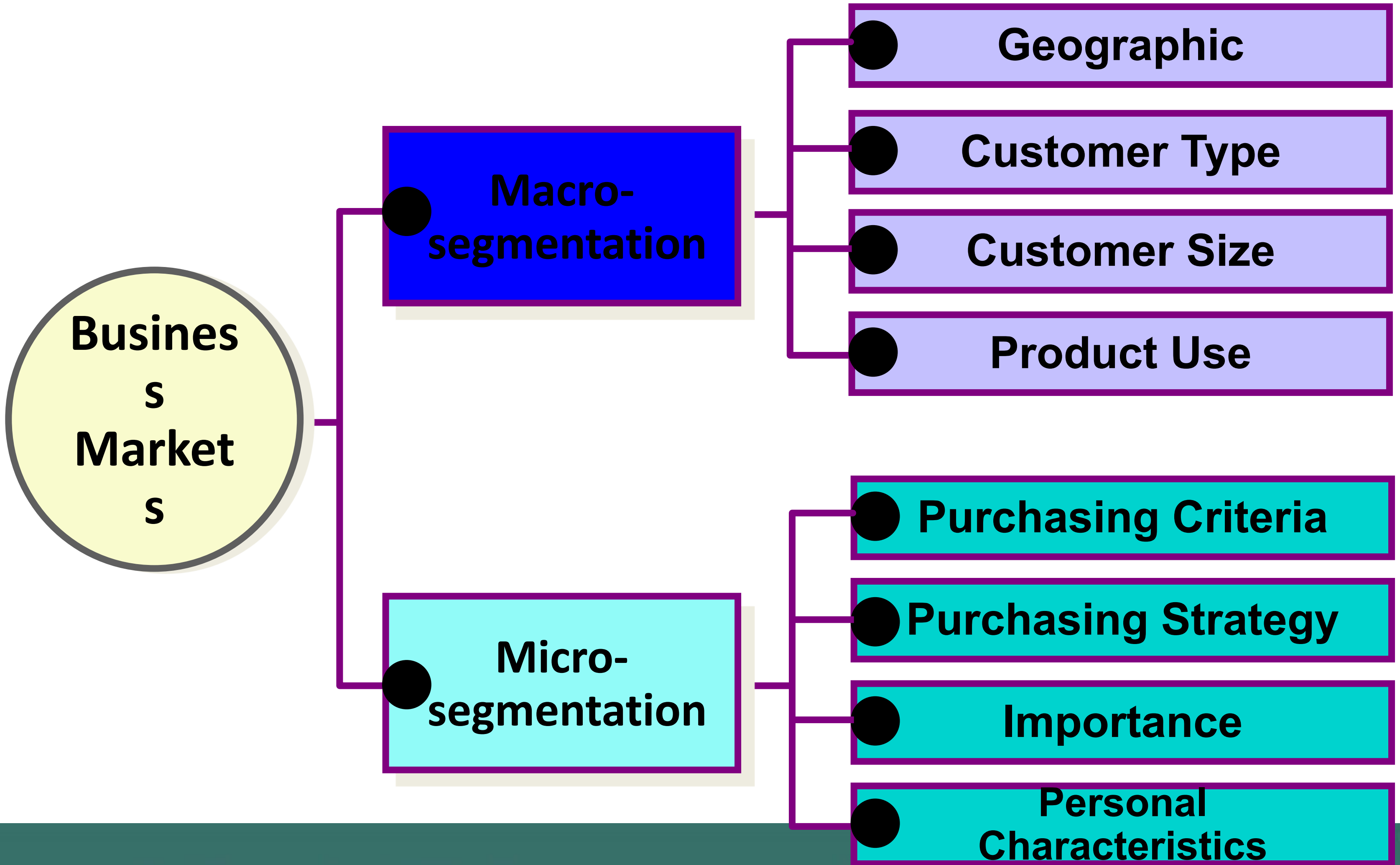
Selective Segmentation Benefits

- Attunes marketer to unique needs of customer segments
- Focuses product development efforts, develops profitable pricing strategies and selects appropriate distribution channels
- Provides valuable guidelines to allocate marketing resources

Consumer vs. Business Profiling

- **Consumer-goods marketers are interested in meaningful profiles of individuals concerning:**
  - **Demographics**
  - **Lifestyle**
  - **Benefits sought**
- **Business marketers profile:**
  - **Organization size**
  - **Organizational buyer's decision styles & buying criteria**
- **Two broad classifications for commercial markets:**
  - **Micro & Macro Segmentation**

Business Marketing Segmentation



Macro-Level Bases

To find viable macro-segments, it is useful to partition buying organizations into smaller groups based on certain criteria.

Criteria include:

1. Characteristics of the buying organization
2. Product service application
3. Characteristics of purchasing situation

Selected Macro-Level Bases of Segmentation

Variables	Illustrative Breakdowns
Characteristics of Buying Organizations	
Size (the scale of operations of the organization)	Small, medium, large; based on sales or number of employees
Geographical location	New England, Middle Atlantic, South Atlantic, East North Central, etc.
Usage rate	Nonuser, light user, moderate user, heavy user
Structure of procurement	Centralized, decentralized
Product/Service Application	
SIC or NAICS category	Varies by product or service
End Market Served	Varies by product or service
Value in use	High, low
Characteristics of Purchasing Situation	
Type of buying situation	New task, modified rebuy, straight rebuy
Stage in purchase decision process	Early stages, late stages

Macro-Level Bases (continued)

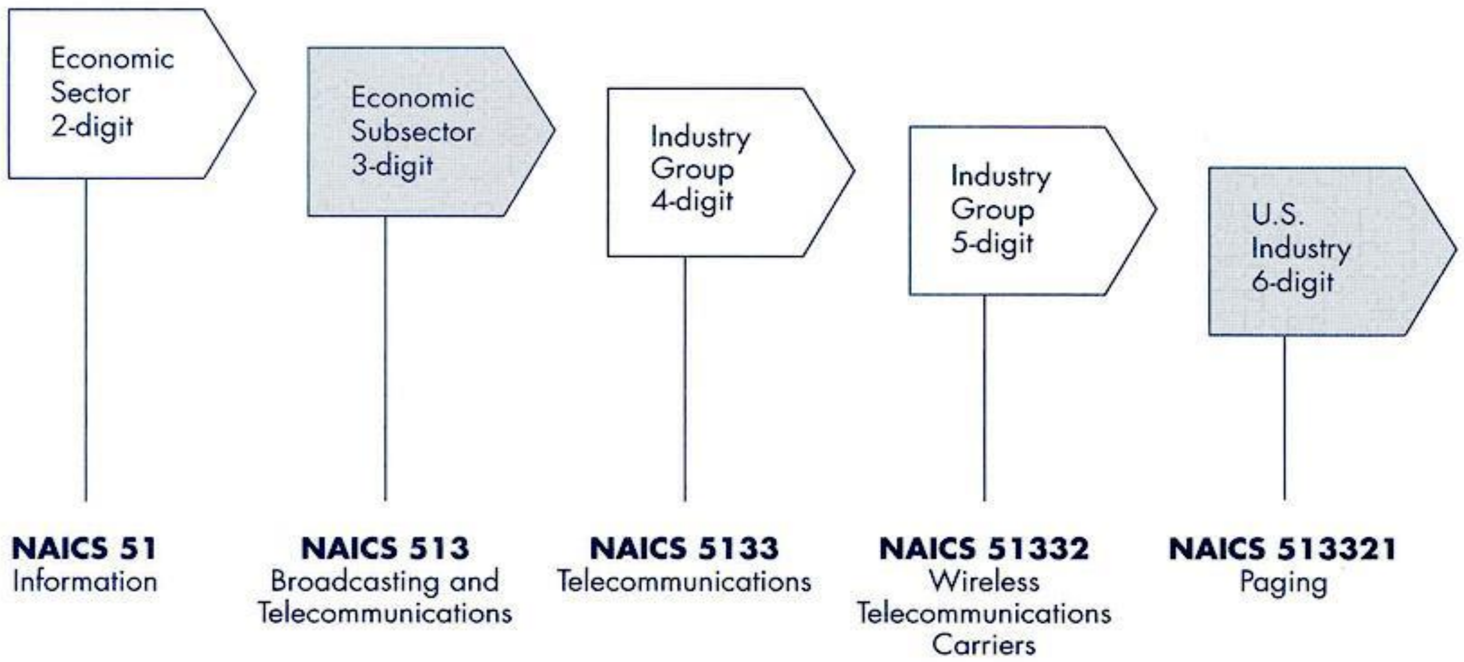
Product/Service Applications:

- Because a specific industrial good can be used in different applications, the market can be divided in specific use applications
- The method to do so is to use the NAICS codes

Classifying Commercial Enterprises

- ☒ NAICS organizes business activity into economic sectors and identifies groups of business firms that use similar production processes

North American Industrial Classification System



Segmentation: Value in Use

- **Value in use is a product's economic value to the user relative to specific alternatives in a particular application.**

- **Value in use can vary from one customer application, or one market segment to another.**

Purchasing Situation

- Segmentation of purchasing situation has an enormous affect on marketing strategy.
- New task buy vs. straight rebuy vs. modified rebuy demands different marketing strategies.
- Because of these variables, marketers are forced to employ a segmentation approach which allows them to develop effective strategies that can be applied to commercial markets.

Characteristics of Buying Organization

- The structure of the procurement function offers challenges and opportunities to marketers.
- Centralized purchasing operates differently than decentralized operations.

Centralized Purchasing

- Forces specialization upon buyers and they usually meet the challenge
- Allows for better coordination of materials purchases
- Results in better method of syncing supply and demand
- Takes advantage of volume savings
- Results in a better coordination between purchasing strategy and corporate strategy

Decentralized Purchasing

1. Local autonomy helps support local businesses—makes buying organization a good neighbor and citizen to the local community.

2. Can cut costs in some cases.

3. Sometimes, local areas offer ideas not available to a central purchaser.

Types of Buyers

- First-Time Prospects: customers who see a need but have not purchased
- Novices: First-time purchasers who've purchased in the past 3 months
- Sophisticates: Experienced customers ready to buy/rebuy

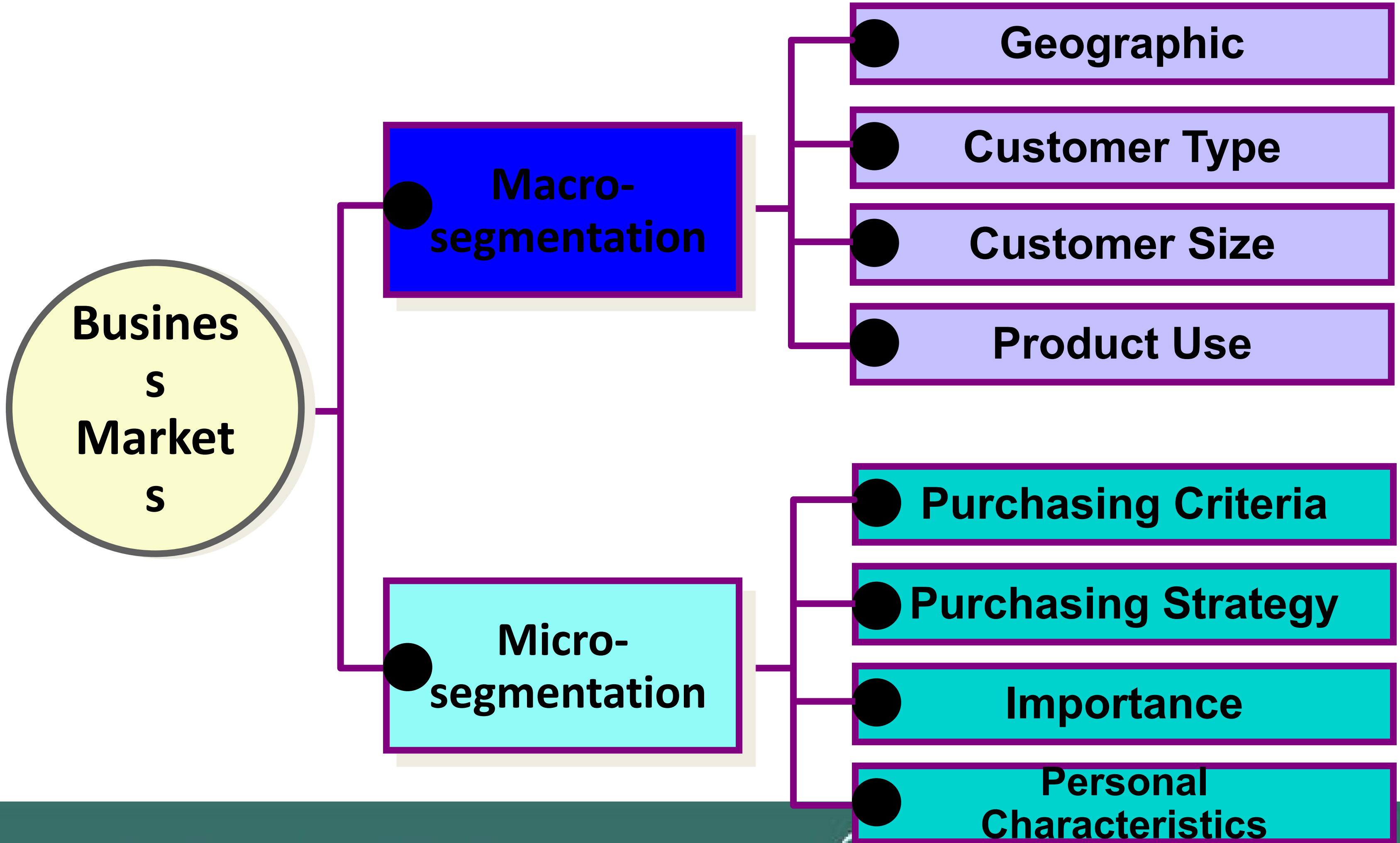
Micro-Level Bases

- Once macro-segments are identified, the next step is to divide each macro-segment into smaller meaningful micro-segments.

- Often, several micro-segments are buried within macro-segments.

- To isolate them, marketers need to move to primary sources of information from:
  - Salespeople
  - Present Customers

Recall - Business Marketing Segmentation



Selected Micro-Level Bases of Segmentation

Variables	Illustrative Breakdowns
Key criteria	Quality, delivery, supplier reputation
Purchasing strategies	Optimizer, satisficer
Structure of decision-making unit	Major decision participants (for example, purchasing manager and plant manager)
Importance of purchase	High importance . . . low importance
Attitude toward vendors	Favorable . . . unfavorable
Organizational innovativeness	Innovator . . . follower
Personal characteristics	
Demographics	Age, educational background
Decision style	Normative, conservative, mixed mode
Risk	Risk taker, risk avoider
Confidence	High . . . low
Job responsibility	Purchasing, production, engineering

Key Criteria

Most business buyers value:

1. Quality
2. Delivery
3. Service
4. Supplier's Reputation
5. Price (all other things being equal)

Price vs. Service

- Often there are tradeoffs between buyers with respect to Price vs. Service
- One study identified four types of buyer segments:
  - Programmed buyers
  - Relationship buyers
  - Transaction buyers
  - Bargain hunters

Types of Buyers

1. Programmed Buyers - Neither price or service sensitive. They buy routine products according to a purchasing program.
2. Relationship Buyers - Value partnerships are not super price sensitive. Product may be moderately important to operation.
3. Transactional Buyers - Price is important but considerations are made to service, depending upon importance of product.
4. Bargain Hunters - Price is everything but always relative to importance of product.

Value Based Strategies

Many customers seek sellers who are able to offer innovative solutions to help them become more competitive. Marketers identify these customers as:

1. Innovation-focused customers
2. Customers in fast-growing markets
3. Customers in highly competitive markets

1. Innovation-Focused Customers

- Committed to being the first in the market with new products and technologies
- Want suppliers who offer innovative solutions or opportunities that help them attract new customers

2. Customers in Fast-Growing Markets

- **Constantly under pressure from competitors in fast-growth markets**
- **Seek suppliers who offer proven performance in technology, manufacturing, marketing and supply-chain management**

3. Customers in Highly Competitive Markets

- **Have mature products in highly competitive markets**
- **Look for suppliers who offer products/services that speed up manufacturing and related processes**
- **Are efficient and effective at keeping overall costs down**

Purchasing Strategies

Micro-segments can be classified according to their purchasing strategies:

1. Some buyers have several suppliers and give each a healthy volume of business.
2. Some buyers need an assured supply, thus giving most of their business to a few suppliers.

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Structure of the Decision Making Unit

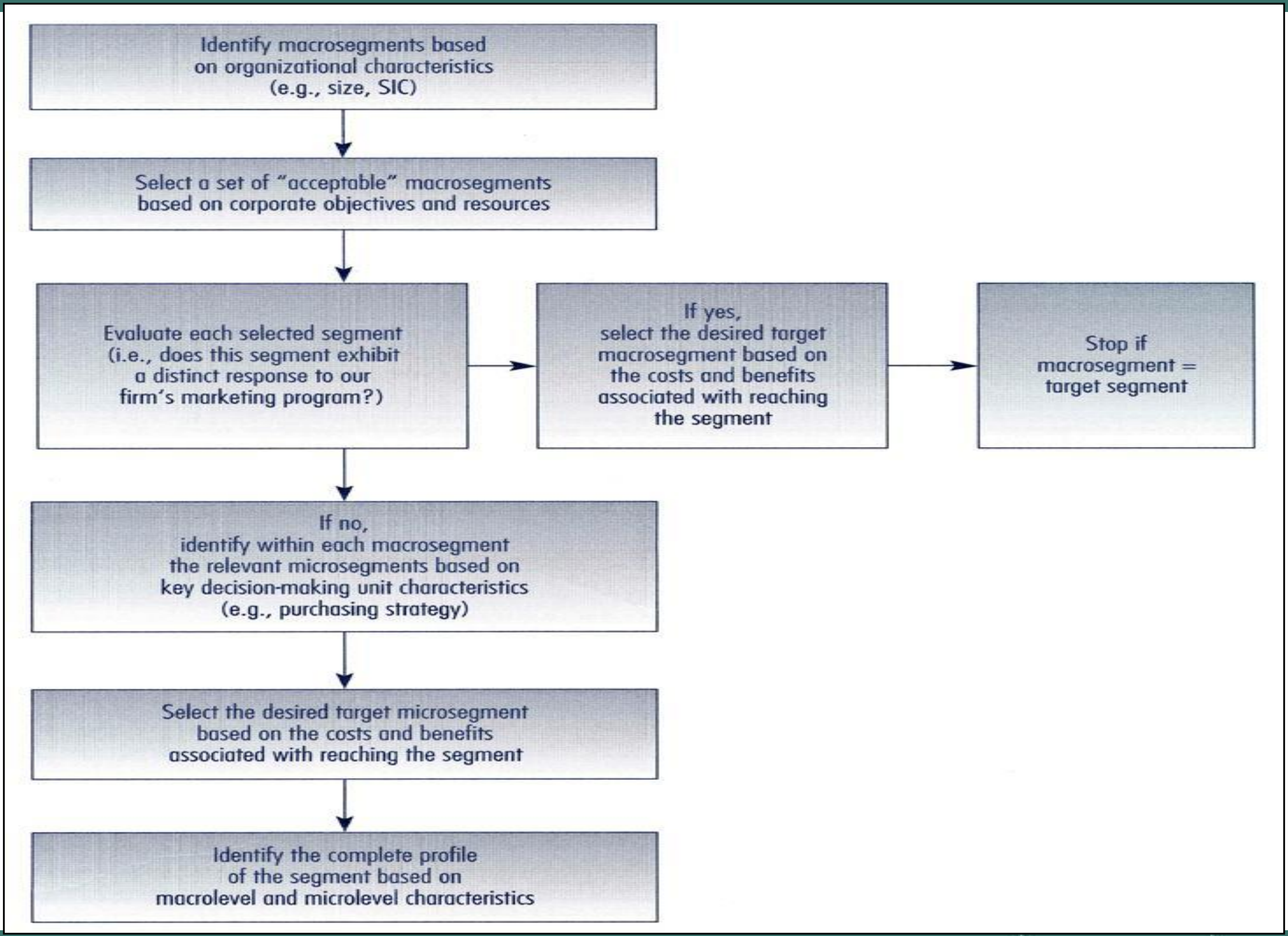
- Whoever makes the buying decisions often dictates how to market to that customer.

- Would it be the engineers, the purchasing agents, or top management?

Other Meaningful Micro-Segments

- ✔ **Importance of purchase –** Appropriate when product is applied in various ways by various customers
- ✔ **Attitudes toward vendors –** Analysis of how various buyer clusters view alternative sources of supply; often uncovers opportunities
- ✔ **Organizational Innovativeness –** Some organizations innovate more and thus are more willing to purchase new industrial products
- ✔ **Personal Characteristics –** Although some interesting studies have shown viability of segmentation based on individual characteristics, further research is needed to explore its potential as valid base for micro-segmentation
- ✔ **New Products –** When new products are introduced, marketers may need to approach new influencers vs. traditional buyers

An Approach to Segmentation of Business Markets



Choosing Market Segments

- As you can see, there are numerous steps to choosing market segments.

- We start by analyzing key characteristics of the organization and of the buying situation (macro-dimensions) to identify, evaluate and select a meaningful macro-segment.

Segmentation Model

1. Identify key characteristics (macro-segments) based on organizational characteristics *(e.g.: size, NAICS)*

2. Consider the buying situation in terms of macro-dimensions *(i.e., Where are they in the procurement cycle – new task, rebuy, modified rebuy?)*

Segmentation Model

3. Select set of acceptable macro-segments based on corporate objectives and resources.

4 Evaluate each segment that possesses distinct needs, is open to a distinct message and is responsive to your marketing program.

5. If Step 4 is successful, select macro-segment as the target market and complete a cost/benefit analysis for marketing to it.

Is it worthwhile?

Segmentation Model

A. If a particular macro-segment is not the right market, then do a micro-segment analysis based on key decision-making characteristics *(i.e., What is their purchasing strategy? Attitude towards vendors? etc.)*

B. Select a new desired micro-segment based on a cost/benefit analysis.

C. Identify the complete profile of the segment based on macro & micro-level characteristics.

Utilizing Segmentation

- Management can utilize segmentation in different ways.
- Companies can categorize their present business customers from:
  1. Bad – Good – Great
  2. Unprofitable to Profitable
- Segmenting both new prospects and present customers in this manner can result in a more profitable organization.

Account-Based-Marketing (ABM)

- **ABM is an approach that treats an individual account as a market.**
- **Done right, it ensures that key accounts are:**
  - **Fully serviced**
  - **Understood with respect to important issues**
- **The strategy is to:**
  - **Focus on that single client**
  - **Develop a collaborative relationship**
  - **Work with the client to mutually develop value propositions that meet the client's business needs**

Implementing a Segmentation Plan

A well-developed segmentation plan will fail unless the following issues are addressed:

1. How should the sales force be organized?
2. What services will the new segment require?
3. Who will provide the new services?
4. How do we contact the new segment?
5. Can we support the new operation?
6. Will new adaptations be necessary to serve the international market?

Segmentation Summary

- **Managing the implementation of segmentation is a difficult task at best. It means the product/service mix needs to be customized for diverse segments.**
- **It demands inter-organizational coordination and cooperation.**
- **Managing critical points of customer contact is one of a marketing manager's fundamental roles.**

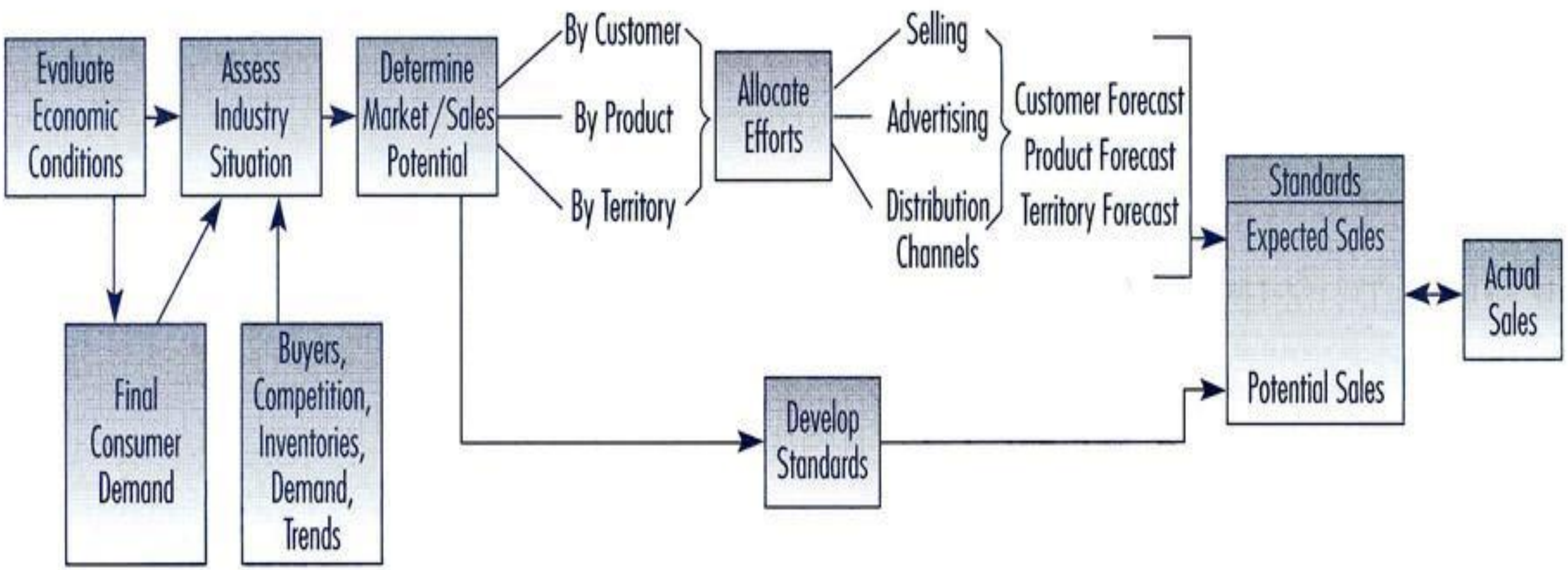
Estimating Demand

- **Estimating demand within selected markets is vital to marketing management!**

- **Forecasting demand represents probable sales. It takes into account:**
  - **Potential business**
  - **Marketing efforts**

- **Virtually all business decisions are predicated on the forecast, both formal and informal.**

Relationship between Potential Demand and the Forecast



Business Plan Prerequisites

- **Before anyone can formulate a business plan, they need to formulate a marketing plan.**
- **Before they can formulate a marketing plan, they need to estimate demand (potential market for their firm's product).**
- **Without a plan, it is very difficult to allocate scarce resources to segments, products, territories, etc. effectively or efficiently.**

Affected Stakeholders

Demand analysis (or lack thereof) affects three broad stakeholder groups:

1. Engineering Design and Implementation teams
2. Marketing and Commercial Development teams
3. External Stakeholders, including:
    a. Investors
    b. Government regulators
    c. Equipment suppliers
    d. Distribution partners

Commercial Questions?

- Where are the customers?
- Where should sales outlets be located?
- How many are outlets are required to meet target market needs?
- What sales level is expected of each outlet?
- What are expected level of revenues, profits, and cash flow are needed to support loans and pricing structures?

Without this knowledge, executives cannot develop sound strategies or effectively allocate resources.

Application of Demand

- **The application of demand rests in the planning and control of marketing strategy by market segments.**
- **Once demand is estimated by segment, the manager can allocate resources on the basis of potential sales volume.**
- **Spending money on promotion has little benefit if the market opportunity is minimal or the competition is fierce.**

Estimates of Probable Demand

Estimates of probable demand should only be made after a firm has decided on its marketing strategy.

- Only after a marketing strategy has been developed can expected sales be forecasted!
- Many firms use the forecast to determine the level of marketing expenditures.
  This is a mistake!
- Marketing strategy <u>determines</u> sales (not vice versa).

Supply Chain Links

- Sales forecasts are critical to a smooth operation throughout the supply chain.

- Timely forecasts allow supply chain members to effectively coordinate their efforts and share in the benefits.

Sales Forecast Data

Sales Forecast Data is used to:

- Distribute inventory within the supply chain
- Manage stock at each level
- Schedule resources at all levels
- Provide material, components and service to a manufacturer

■ Accurate forecasts go hand-in-hand with good business practices throughout the supply chain

Methods of Forecasting Demand

1. Qualitative
   – Executive Judgment
   – Sales Force Composite
   – Delphi Method
2. Quantitative
   – Time Series
   – Regression (causal)
3. Collaborative Planning Forecasting and Replenishment
4. Combining Techniques

Qualitative Method: Executive Judgment

- **Executive Judgment:**

  This method is very popular because it is:

  1. **Easy to understand**
  2. **Easy to apply**

- Executives from various departments (Sales, Marketing, Accounting, Finance, Procurement) are brought together and apply their collective knowledge to the forecast.

Executive Judgment: Benefits

- Executive judgments are often used in conjunction with quantitative approaches to forecasting
- Tend to be fairly accurate when:
  1. Forecasts are made frequently & repetitively
  2. The environment is stable
  3. The link between decision, action and feedback is short

Executive Judgment: Limitations

- Does not offer systematic analysis of cause & effect relationships
- No formula for estimating derived demand
- New executives may have trouble making a reasonable forecast
- The forecast is only as good as executives' collective knowledge and experience
- Difficult to compare against alternative techniques

Qualitative Method: Sales Force Composite

- **Rationale is that the sales force knows their customers, markets and competition, thus they can estimate their market fairly accurately.**
- **Having the sales force involved in the forecasting process helps them understand how the forecast is derived and boosts their incentives to achieve desired sales levels.**
- **The composite forecast is attained by getting input from all their salespeople.**

Sales Force Composite: Benefits

- **More successful if the dyadic (buyer/seller) relationship is close**
- **Inexpensive**
- **Facilitates salespeople to review their account in terms of future sales**
- **However, few companies rely solely on their sales force estimates**
- **They are reviewed by top management and are compared to quantitative methods**

Sales Force Composite: Limitations

Limitations are similar to the executive judgment approach

- **Not a systematic analysis of cause & effect**
- **It's still only judgment/opinion**
- **Some salespeople overestimate their forecast to look good**
- **Some salespeople underestimate to lower their quota or increase commissions**
- **Generally, short term estimates are accurate, but long-term estimates are lacking**

Qualitative Method: Delphi Method

1. **It starts with a moderator (analyst) who attains a forecast opinion from a panel of anonymous experts**
2. **These estimates (along with reasons) are passed around to the entire group and new estimates are evoked.**
3. **Rounds continue until a consensus is reached.**
4. **A panel may consist from 6 to 100's depending upon the purpose, and numerous rounds are conducted until a consensus is attained.**

Delphi Method

- **It is generally applied to long term forecasting of demand.**

- **It's good for new products or for situations that are not well suited for quantitative analysis.**

- **Finally, like other qualitative approaches, the Delphi method is difficult to accurately measure.**

Summary of Qualitative Forecasting Techniques

Technique	Approach	Application
Executive judgment	Combining and averaging top executives' estimates of future sales	Ballpark estimates; new product sales estimates; intermediate and long-term time frames
Sales force composite	Combining and averaging individual salespersons' estimates of future sales	Effective when intimate knowledge of customer plans is important; useful for short and intermediate terms
Delphi method	Consensus of opinion on expected future sales volume is obtained by providing each panelist with the projections of all other panelists on preceding rounds. Panelists modify estimates until a consensus is achieved.	Appropriate for long-term forecasting; effective for projecting sales of new products or forecasting technological advances

Typically, qualitative estimates are merged with quantitative ones.

Quantitative Methods: Time Series

- Time Series uses historical data
- Rationale is that the past patterns will apply to the future
- The analyst needs to understand all possible patterns to include:
  - Trends
  - Seasonal patterns
  - Cyclical patterns
  - Irregular patterns
- Time Series methods are well suited for short range forecasting

Quantitative: Regression or Causal Analysis

- **Uses factors that are identified as affecting past sales**
- **$Y = a + bX$ Linear Regression equation**
- **To be valid, there needs to be a direct link between X (independent) & Y (dependent) variables. For example, X cause (housing starts) should affect future sales (demand) of Y (new furniture or hardware or wood, etc.)**

Regression Analysis

- **Much historical data is needed**
- **Some will come from accounting data**
- **Other data can come from both primary and/or secondary sources such as:**
  - **Project specific surveys (primary), or**
  - ***Survey of Current Business (secondary)***
  - **Reports developed by the Dept. of Labor that are especially data related to employment statistics**
  - **Industry specific research studies**
  - **Census data**

Regression Analysis: Limitations

- Although regression analysis is fairly accurate, there are some limitations, thus the need for caution:
  - Although some variables are highly correlated, they may not have a genuine cause/effect relationship.
  - Again, there is a need for much data, however some data may not be available.
  - Regression analysis uses past data and may not be relevant to rapidly changing events, thus invalidating past relationships.

Quantitative: Which Method?

- Research suggests that strategists should choose a forecast method that is based on the market's "underlying behavior" rather than on a "time horizon"
- When markets are sensitive to market or environmental changes, causal methods work best
- When market shows no sensitivity to market or environmental factors, time series is more accurate

Using CPFR to Estimate Demand

- **CPFR: Collaborative Planning Forecasting & Replenishment involves deriving and sharing information by combining the efforts of many functional areas within the firm and between channel partners to estimate demand.**
- **With respect to the supply side, functional areas include Sales, Marketing, Production, Logistics and Procurement will be called upon to discuss their upcoming plans.**
- **On the demand side, planners will reach out to customers, distributors and manufacturers to discover their plans.**

Result of CPFR

- **Result: Often, the forecast of demand is very accurate!**
- **Partners can map this shared information in a way that:**
  1. **Fits into their organizational needs**
  2. **Points out where plans deviate from their own**
  3. **Allows collaboration that assesses assumptions which may lead to different estimates**
- **This iterative process encourages the supply chain to synchronize activities better while keeping the enterprise planning process intact.**

Combination Approach to Forecasting

- **Research suggests that forecasting can be improved by combining several forecasting methods.**

- **Experts suggest that management should use a composite forecasting model to include both Qualitative and Quantitative factors.**

- **Furthermore, rather than searching for a "one best method", they should consider the broader range of factors that affect sales, and integrate them into a "composite" forecasting approach.**

Femøvej 3 | 4700 Næstved | +45 5076 2640