Customer Segmentation:

The First Critical Task of Strategy

Reasons for Customer Segmentation

- Don’t commoditize your customer. You should not treat every customer equally.
- Customers are different in many ways:
  - Needs
  - Capabilities
  - Business economics and strategies
  - Willingness to engage in business with you
  - Demographic characteristics: size, profitability, participation in various vertical markets, geographical coverage
- The most attractive customer usually is the one that has the greatest gap between its needs and your ability to satisfy them.

The Key Mechanisms to Serve the Customer

- **Customer Engagement Process - How do you establish a proper association with the customer?**
- **Customer Integration - The degree of value-added you provide to the customer based on the knowledge and services you transfer.**
- **Horizontal Breadth - The depth of the portfolio of products and services you provide.**

All these mechanisms have to be tailored to each individual customer and result in very different degrees of customer bonding.

Criteria for Customer Segmentation

The most critical dimensions for customer segmentation are:

- Customer Attitudes
  - Castrol - How we want to treat the customer
- Customer Needs and Degree of Self-Sufficiency
  - Unilever de México - Segmentation by channels
- Different Degrees of Value Added
  - Waste Management Co. - Different degrees of customer bonding
- Customer Behavior and Their Buying Practices
  - Synthes - Different customer buying patterns
- Redefining Customer Experience
  - Telefónica Móviles /Colombia - Reducing customer churn

CASTROL -

DECOMMODITIZING THE CUSTOMER

Castrol - Lubricants
Segmentation According to Customer Attitudes

Castrol considered three Tiers in each market segment
(Primary Target Segment – Productivity Conscious Customers,
Secondary Target Segment – Cost Conscious Customers,
The Least Desirable Segment – Price Conscious Customers)

Value Proposition:

Customized lubrication solution involving products and services

- Do not treat customers equally
- Not all customers are equally receptive for solutions

Productivity Conscious
These customers are eager to receive support that will enhance their productivity, reduce total costs, and promote higher sales.

Cost Conscious
These customers are concerned about total costs but they believe new production does not neces-sarily yield higher sales or economies of scale.

Price Conscious
These customers are basically buying from the supplier that offers the lowest price.

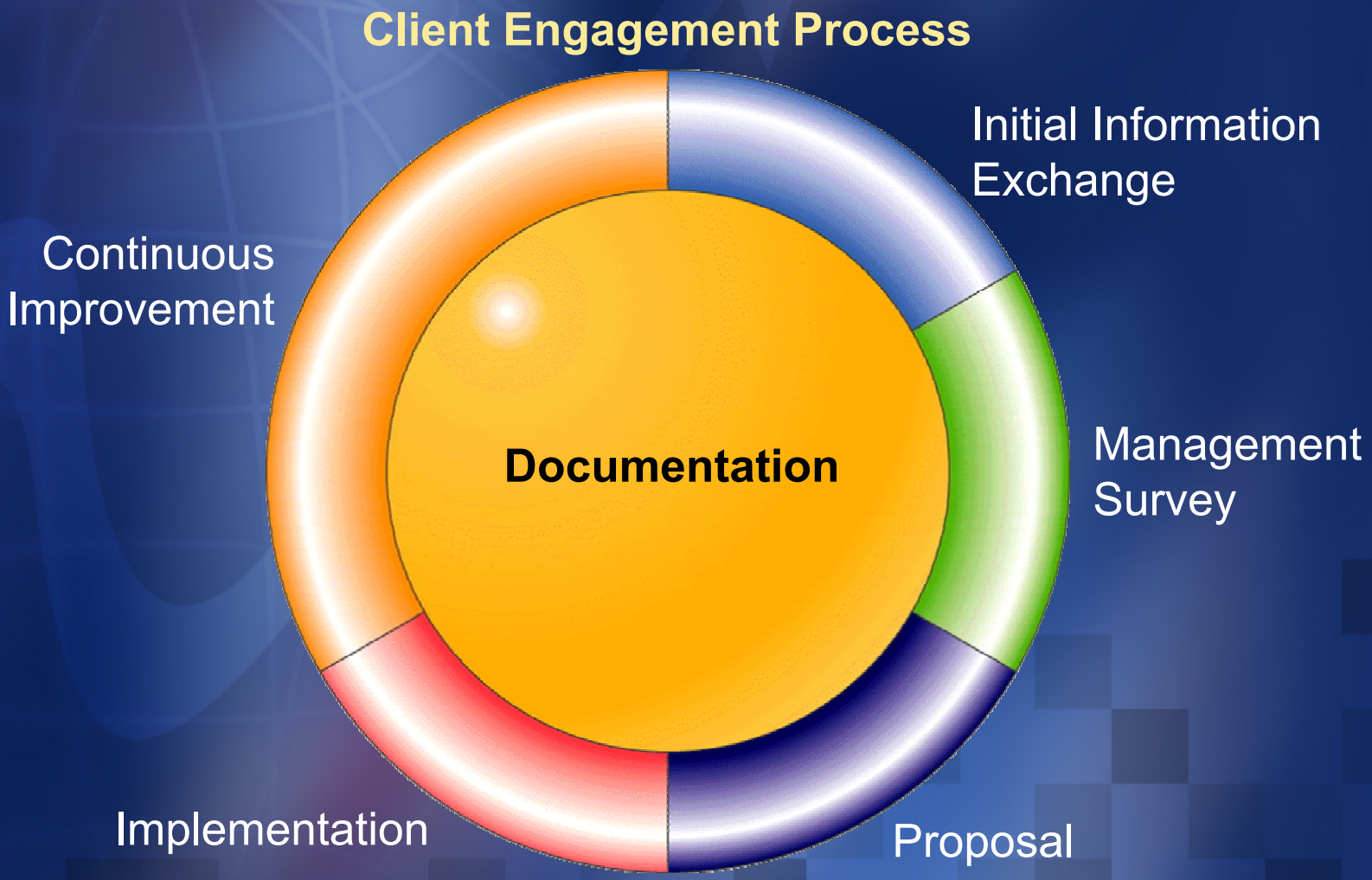
What is Castrol Logic?

A customized lubrication solution involving products and services that results in documented:

Cost Reductions
&
Productivity Improvements

Transforming the Organization

Rethink the customer engagement process



Source: Castrol

Lessons from Castrol

- You cannot and should not treat every customer equally - Differentiate a value proposition to each relevant tier.
- Often a very insightful way to segment your customer is by their willingness to do business with you in a chosen way. We call it segmentation by attitudes.
- Once you adopt a different value proposition for each tier you should change accordingly the customer engagement process. Remember “Sales are too important to be left to the salesforce.”

Unilever de México -

Segmentation According to Channels

The Process

- The Board spent a week with Arnoldo defining the strategy, using the Delta Model.

- The Key elements included:

  Customer segmentation!!!

  Identification of key segment interactions

  Identification of services to offer each segment

  Identification of potential complementors.

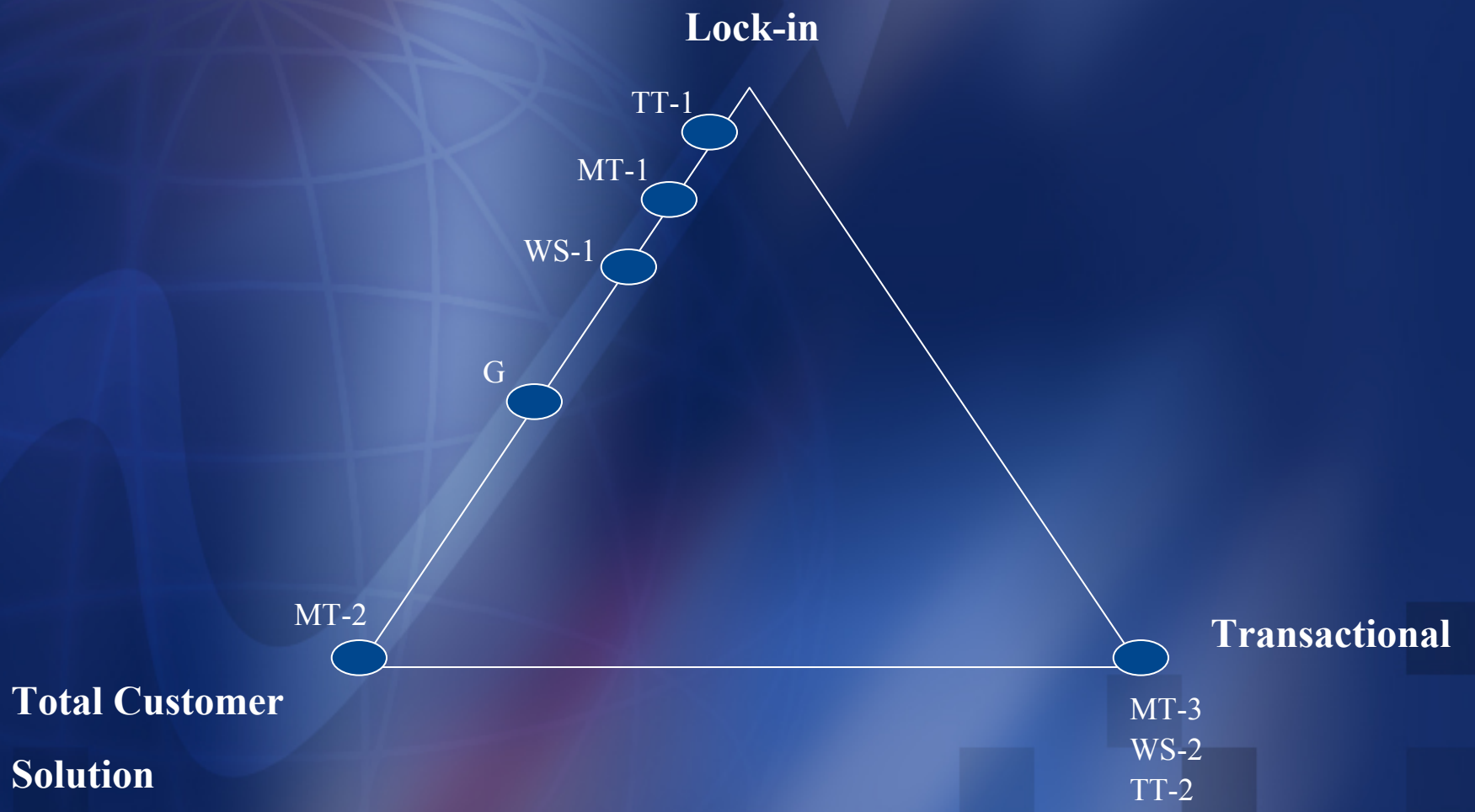
  Integration to backend systems from UL and complementors

- We identified key insights that integrated the ways we sought to serve the various customer segments.

The Customer Segments

- Modern Trade:
  - Large Local Chains (MT1)
  - Large International Chains (MT2)
  - Smaller Local players (MT3)
- Traditional Trade:
  - The 100,000 largest (TT1)
  - The other 4-600,000 (TT2)
- Wholesale Trade:
  - The Biggest Players (WS1)
  - The Rest (WS2)
- Government Stores (G)

UdM Delta Model



Customer Segmentation

Strategic Option	Customer Tier	Members
Lock-in Preferred customers focused on growth when we provide transfer of knowledge in category management, ECR, efficient logistics, promotional activities, consumer understanding	MT-1	Comex, Gigante, Soriana, Chedraui, HEB, Casa Ley, San Francisco, Calimax, OXXO, 7 eleven
	WS-1	Sahuayo, Garces, Chapa, Ibarra, Mtz Taylor
	TT-1	Key Changarros (approx. 100,000)
	G	Government Stores (IMSS, ISSTE, Diconsa)
Relational - Support Major international customers with established businesses practices whom we provide efficient support to become their preferred suppliers, avoiding conflict and rivalry	MT-2	Wal-Mart, Carrefour

Customer Segmentation

Strategic Option	Customer Tier	Members
Transactional Arm length relationship with minimal level of customized services to cover their specific needs	MT-3	Small Size Locals
	WS-2	All other wholesalers
	TT-2	Rest of changarros

Complementors	- Bank	- Kimberly-Clark
	- Tv Azteca	- Elektra

The Basis of the Key Insights

- Wholesale Trade sales and margins are both shrinking. They need a new source of growth and profits.
- The MT1 segment is shrinking. They do not have the scale to compete with Wal-Mart's distribution know how and economies of scale.
- TT segment feels ignored, as major supplier companies offer special deals to MT1 & 2. TT operating costs are lower than MT, but product purchase costs are higher.
- Unilever Distribution costs are high.

The Insight

- Form a network from existing Players
  - Reduce # of Unilever Distribution Centers from 9 to 1
  - Use Existing WS1 warehouses as DC's
  - Expand WS1 relationship into logistics provider for MT1, MT3, & G
  - Implement direct sales force for TT1, deliver through WS1
  - Add Banking provider to improve Credit
  - Add Media provider to provide advertising services
  - Add White Goods Retailer to provide promotion fulfillment
  - Add other non-competitive suppliers to spread costs

The Delta Network Business Opportunity

EXPECTED BENEFITS TO CHANGARROS:

- Free workstation (key technnological improvement for store growth)
- Guaranteed competitive prices to modern trade (on UL and KC products)
- Access to credit line for the store (through Bank)
- Improvement of service received (more control over delivery times)
- Transfer of merchandising expertise (through sales advisor)
- Individual store management advice & training (through sales advisor)
- Direct access to promotions information (through workstation)
- Information about competitive landscape (through workstation) (e.g. average price of changarros - for Pricing Strategy)
- Access to Business Management tools (through workstation) (e.g. Inventory & sales statistics)
- Identification of its most valuable customers (through brand loyalty programs)
- Relative exclusivity (1 out of 6 changarros will be in the network)

The Delta Network Business Opportunity

EXPECTED BENEFITS TO WHOLESALERS:

- Territorial exclusivity (restricted number of wholesalers per city: 1 or 2)
- Increased sales & order flow coming from modern trade and government stores in its territory
- Increased order size coming from changarros (50% approx. Abastex experience)
- Free dedicated salesforce to sell UL/KC products for its benefit (additional source of sales growth at no cost)
- Increased inventory turnover resulting in less working capital being tied up
- Operational cost savings resulting from new order entry process
- Direct access to competitive market information & deep knowledge of its customers (through full POS system)
- Category management know-how provided by UL & KC to define optimal sku mix
- Increased loyalty from changarros
- Free suport from UL & KC for its technological improvement process

The Delta Network Business Opportunity

EXPECTED BENEFITS TO MODERN TRADE & GOVERNMENT STORES:

- Substantial service improvement - particularly in terms of delivery times (direct delivery from wholesaler to each individual store)
- Guaranteed prices - UL & KC will set the prices at which the wholesaler will commit to sell their products
- Cost savings because of supply chain & inventory management improvements
- Reduced TV advertisement cost (leveraging UL & KC relationships)
- Identification & knowledge of its most valuable customers (through brand loyalty programs)
- Free suport from UL & KC for its technological improvement process

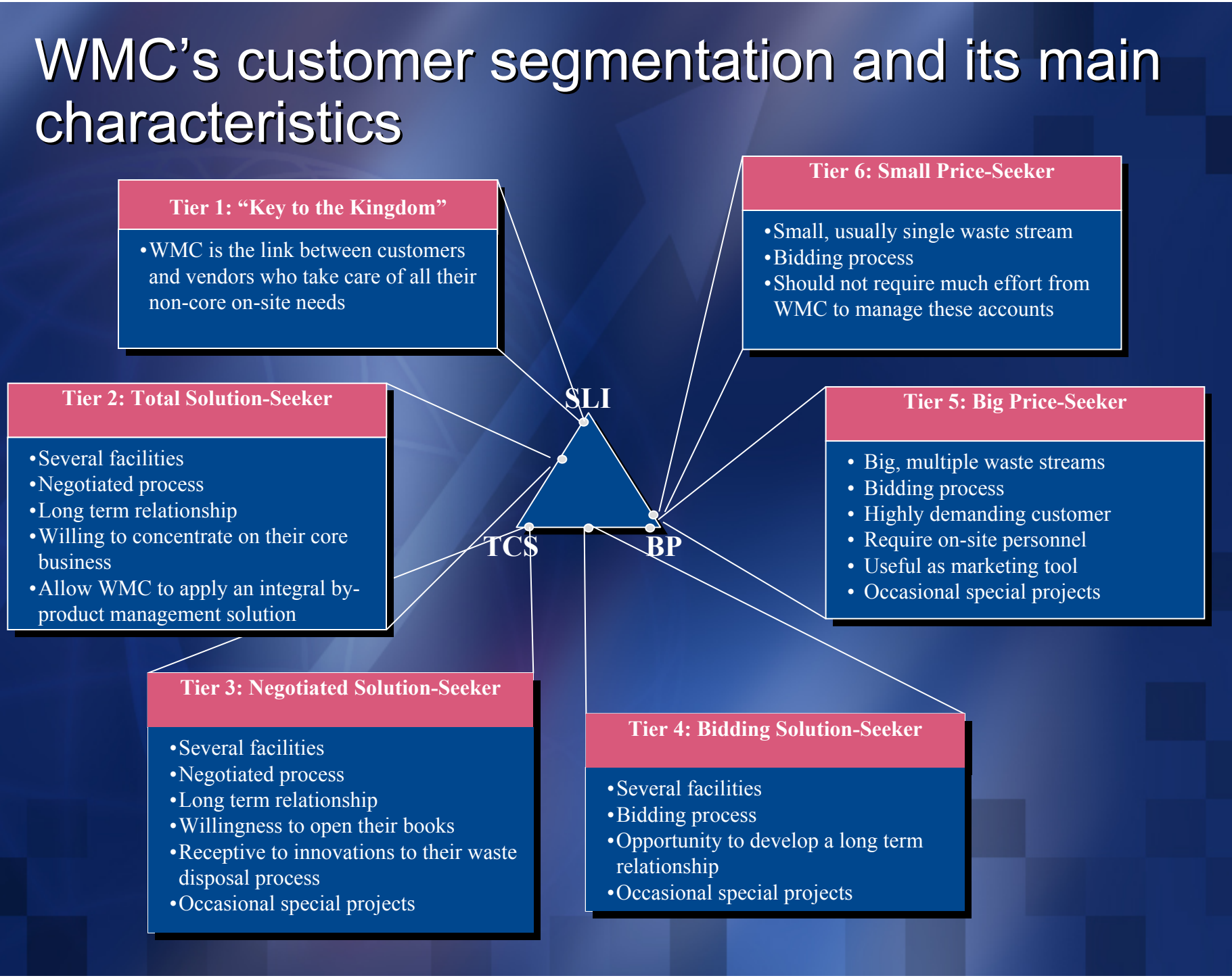
Lessons from Unilever de México

- Challenge the conventional wisdom. Your most important customers could very well be the most neglected. Remember the Gospel “The last ones will be the first ones”
- A critical element of a modern strategy is to position yourself within the network. Information Technology is the key to implement this principle.

Waste Management Company (WMC)-

Segmentation According to Potentials for Customer Lock-In

WMC's customer segmentation and its main characteristics



We would like to structure our value proposition as of today by clearly stating what we offer and how

WHAT Solutions we provide to customers	HOW Set of value delivery systems we use to provide our service	
▪ Compliance with regulations (environmental, safety)	- Liability insurance - Supplier certification process	- Personnel training - Constant review of evolving regulations
▪ Reduce total cost of by-products handling and better customer service	- Relationships and bargaining power with vendors (low prices, better service) - Culture focused on customer service	- Eliminate in-house vendor auditing process - Incentive systems aligned through the system (customer/firm/vendor)
▪ Reduce administrative costs and headcount	- One-stop shop - One invoice	- Single Points of Contact (SPOCs) - The WMC system provides accurate information
▪ Improve productivity, allow company to focus on core business	- Expertise / R&D capabilities in logistics, recycling, laboratories, etc. - Constant sharing of best practices	- Leverage of group capabilities - Knowledge of the value chain
▪ Total facility management	- Access to the best network of partners - Joint services with partners (R&D, information, services, etc.)	- Evaluation system to ensure the best service at the lowest cost

COMPLEXITY

Our value proposition should be tailored to efficiently and profitably serve the different tiers of customers

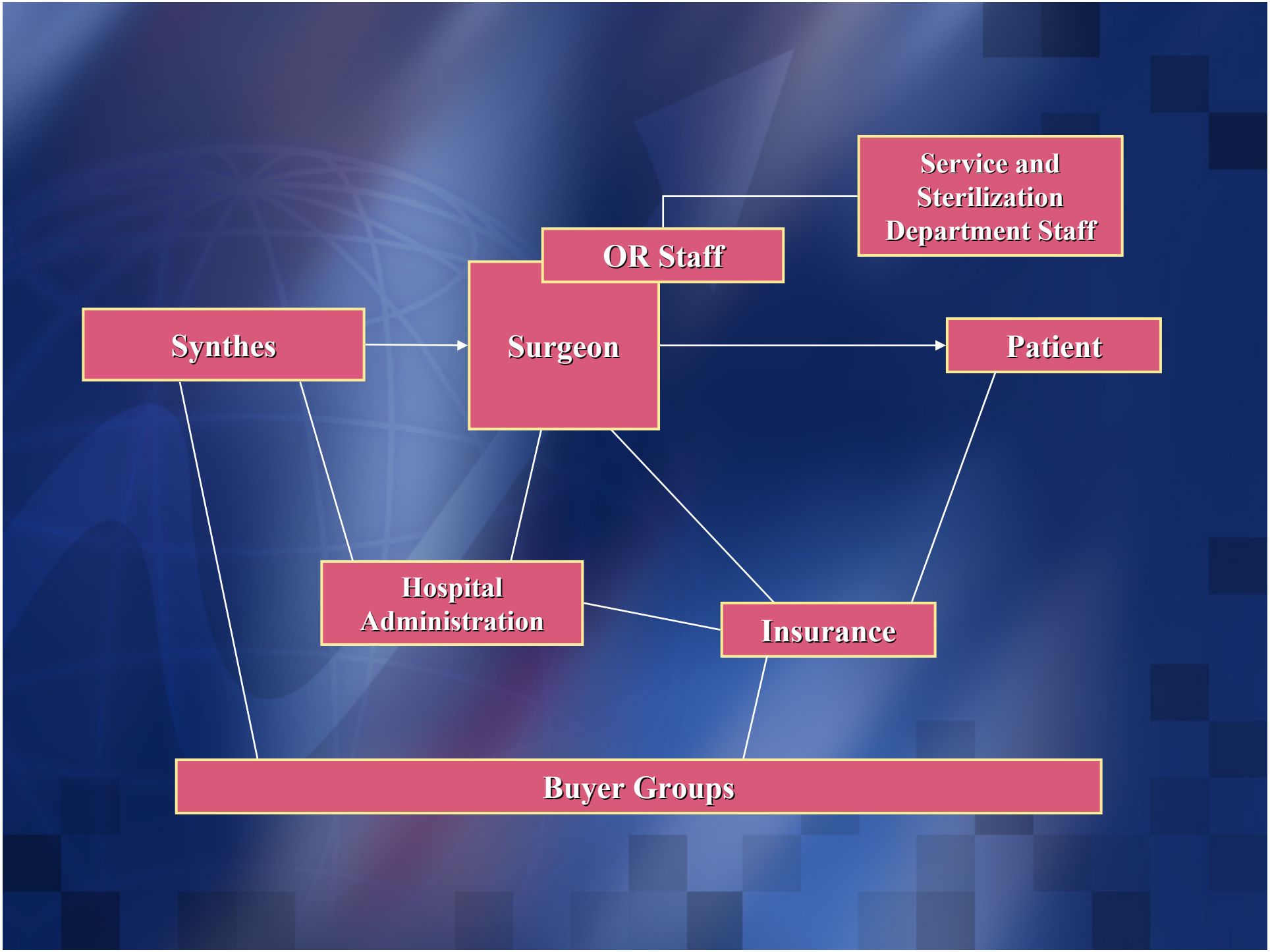
Tier	Solutions we provide	Benefits for Customer	Benefits for WMC
6 **Small Price Seeker**	•Compliance with regulations •Lowest cost in by-product handling •Keep track of activities •*If profitable,* look for improvements	•Lowest cost available in the market	•Small margin gains in bided activities •One-time-events with potentially high margins
5 **Big Price Seeker**	•Handle multiple waste streams	•Better customer service •Expertise	•"Looks good in our resume" •Opportunity to learn best practices and new processes
4 **Bidding Solution Seeker**	•Reduce administrative costs and headcount	•Additional services & improvement projects if relationship develops	•Step-up of customer tier if able to develop relationship
3 **Negotiated Solution Seeker**	•Improve productivity, allow company to focus on core business	•Additional cost savings from non-waste processes	•Long term relationship •Higher margins
2 **Total Solution Seeker**	•Total facility management	•WMC as an on-site partner •Concentrate in core business	•Customer lock-in
1 **Key to the Kingdom**	•Total facility management	•One-stop solution	•System lock-in

Lessons from WMC

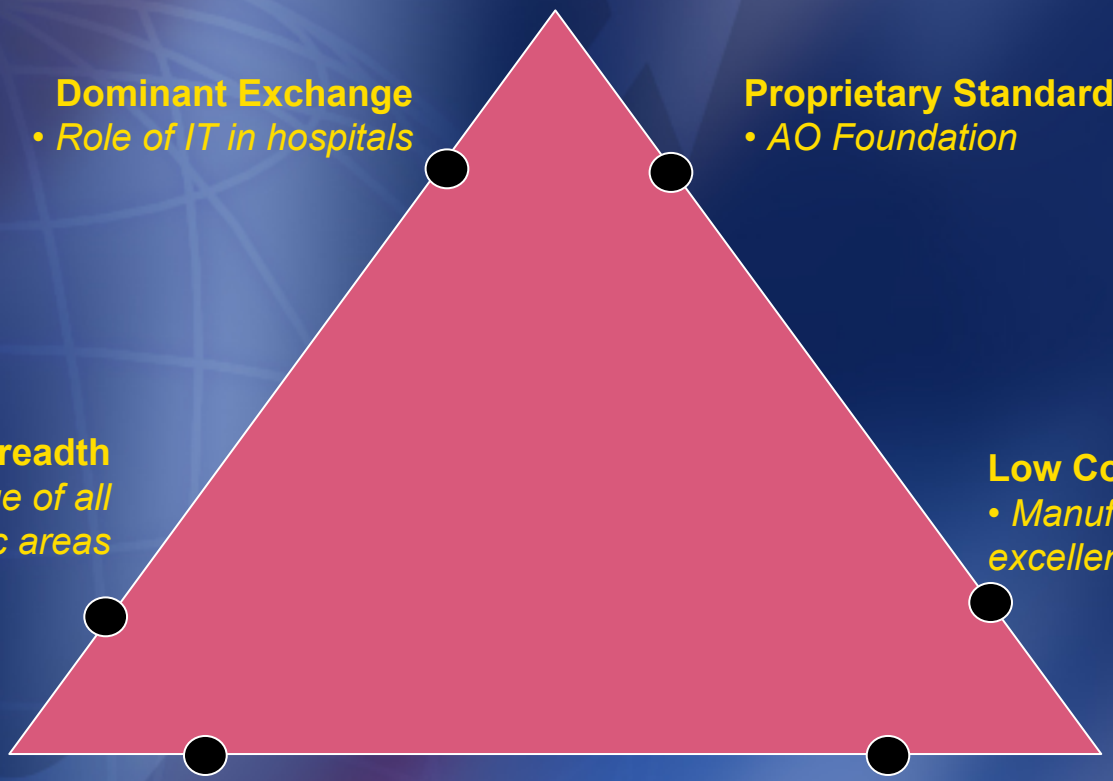
- A power segmentation is based on increasing degrees of customer bonding, resulting from increasing value added provided to the customer.
- The progression of increasing value added implies greater knowledge transfer, greater margins and profitability, greater complexity in the relations, and greater bonding.
- System Lock-In is not necessarily a feasible option to pursue for many businesses. However, the Dominant Exchange is often the most relevant form of System Lock-In.
- The lesson of WMC is to segment to customer base in increasing degrees of the Systems Lock-In culminating in the achievement of Dominant Exchange. If you can gain that position the potential rewards are immense.

Synthes -

Segmentation According to Customer Behavior and Their Buying Practices


Service and Sterilization Department Staff
OR Staff
Synthes
Surgeon
Patient
Hospital Administration
Insurance
Buyer Groups

Synthes



Dominant Exchange
- *Role of IT in hospitals*

Proprietary Standards
- *AO Foundation*

Horizontal Breadth
- *Coverage of all therapeutic areas*

Low Cost
- *Manufacturing excellence*

Customer Engagement and Customer Integration
- *Role of Consultants*
- *Education*
- *Intimacy*

Differentiation
- *Continuous New Product Development*

Synthes Customer Segmentation

Customer Tier	Description

(1)
Professors & Opinion Leaders
	• Working at University Hospital, Teaching
	• High number of procedures
	• Active surgeon with own core specialty
	  – Large segments of specialty within his/her influence
	• Respected among peers
	• Active in research & development
	  – Publications
	  – Active as scientific speaker
	• Independent!
	• Loyal because he/she is convinced of superiority of products
	• Respected by hospital administration
	• Key decision maker regarding implant suppliers

(2)
Non-User
(high volume)
	• Bond to competition
	• For reasons of:
	  – Strict budget control
	  – Clinical practice/teaching schools
	• Using high volume of implants

(3)
Young High Potential
	• Innovative
	• Ambitious; Go beyond daily business
	• Interested in research & publication
	• Looking for recognition from:
	  – Opinion leaders/professors
	  – Peers
	  – Industry (financial sponsoring)
	• Need to have a “godfather”
	• Preparing/Learning to be a specialist
	• Looking for R&D support (financial, implants, etc.)

Synthes Customer Segmentation

Customer Tier	Description
(4) Buyer Groups	• Negotiating body for a group of hospitals • An organization designed to increase the purchasing power of hospitals and to optimize purchasing and administration costs for hospitals • The one paying the bill • Focus on bundling (products, logistcs, tenders)
(5) "Massmarket" Surgeon	• High volume • Stratec makes high turnover with them • Broad range of procedures • Mostly large public hospitals
(6) Low Volume & Local Hospital	• Community hospital • Use commodities/standard products • Buy single items from all products
(7) Patient (undergoing elective surgery)	• E.g., Education of projected end users

Who is our customer?
Who makes the decisions for traumatology implants and instruments?

Tier 1 Business Scope

Business Dimension	Tier 1: Professors/opinion leaders
Products	• Full range, pioneer products
Services	• Facilitate education, provide and support access to AO • Support for R&D (financial,implements, documentation & engineering)
Customers	• 250 approximatel (list requested from the countries))
Channels	• Direct • - Sales consultant and sales manager relationship • - Project leaders • - Support CEO, Senior Mgmt (occasionally)
End users	• Polytrauma and high degree of complication
Complementors	• AO Network • Power tool business • Access to reference hospitals • Software provider (documentation, digital services) • ORP staff • Scientific publications
Unique Competencies	• High-end products • Development and engineering capability • Technical education at all levels (from sterilization departments to surgeons) • Logistics/loan sets • Highly-trained consultants (clinical and product specific)

Customer Value Proposition

Customer Tier 1 Professors and opinion leaders	Value Proposition
Set of experiences we will provide to the tier	Provide latest innovative clinical solutions in a collaborative spirit
Set of value delivery systems needed to provide the experiences	• Sales force (experienced & highly qualified) • Innovative products • AO networking • Davos course experience and AO research center • Engineering development capacity and know-how
Value appropriation	• Value gained by the customers: - Recognition by peers patient and industry • Value gained by us: - loyalty & input - support for development & sales/teaching • Value shared by both: - productive partnership

Lessons from Synthes

- The customers' behaviors and buying practices often provide relevant criteria for segmentation.
- This allows you to detect the special needs of each customer tier, which are translated into specific value propositions.
- Your segmentation does not need to be limited to the actual customer (the one who pays). It might also include relevant implementors.

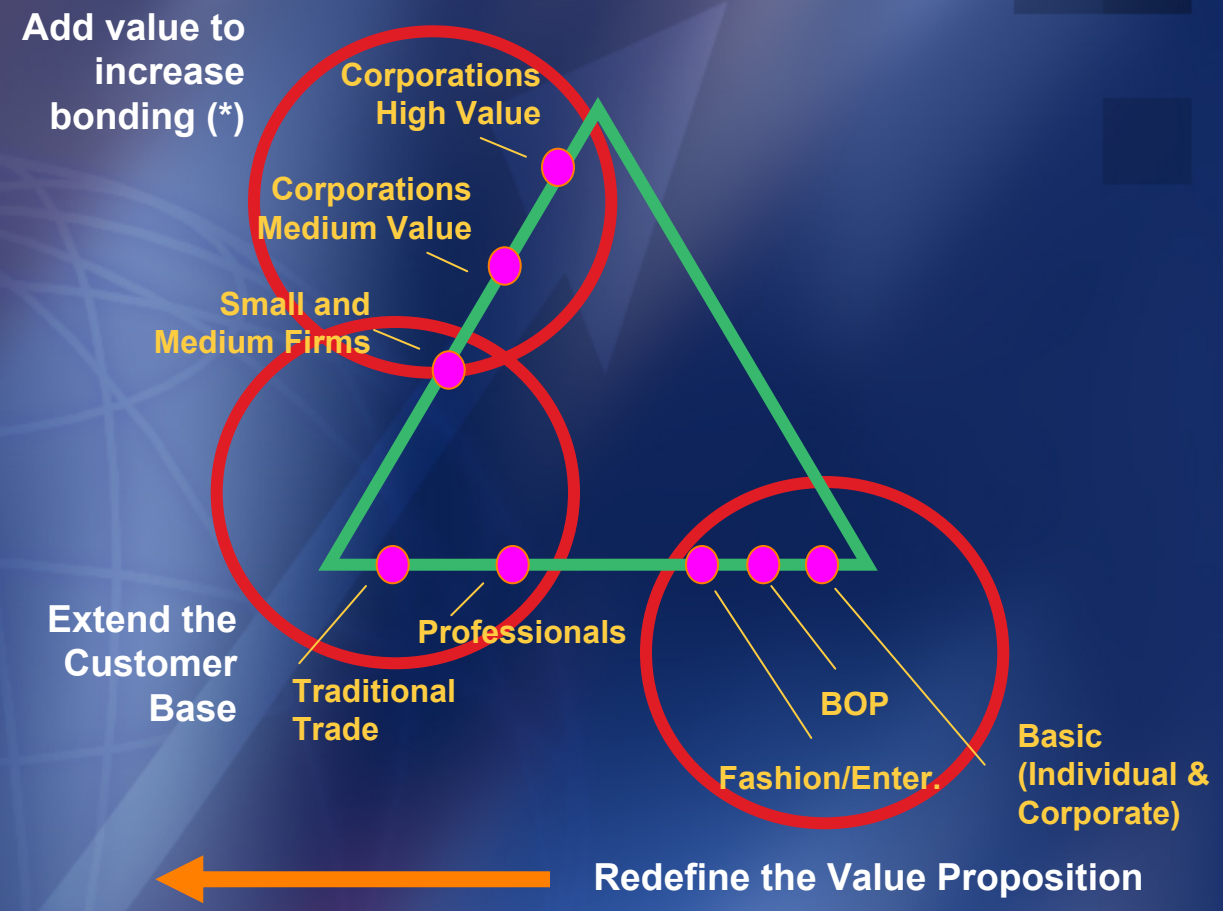
Telefónica Móviles - Colombia

Increasing Customer Bonding (Reducing Churn) and Redefining Customer Experience

Telefónica Móviles - Colombia

CUSTOMER SEGMENTATION

Tier	Value Added	Channels
Corporations High Value Added Medium Value Added Basic Needs	Increase customer bonding by developing customized value-added business applications.	Corporation → Multifunctional Team
Small & Medium Size Firms	Improve managerial capabilities and business performance	
Professionals Independents Traditional Trade (Tenderos")		Professional → Expert Plus
Individual/Consumer Basic BOP (bottom of the Pyramid) Fashion/Entertainment	Enrich the experience of use by relating to affinity groups.	Individuals → Telemarketing and e-business



Decommoditization = Learning + Customization + Value Added

(*) Restricted Access = Increase barriers to entry for competitors and increase barriers to exit for customers
Dominant Exchange = By mining the extraordinary information access and data bank

Strategic Agenda

1. The Full Development of the Country Network
2. IT Platform
3. Individual-Basic Service
4. Corporations
5. Sales-Force Development
6. Traditional Trade
7. Small and Medium Size Firms
8. Colombians Abroad
9. Complementors
10. Alignment of Firm Infrastructure
11. Broad Band
12. Suppliers

Lessons from Telefónica Móviles

- Don’t ever accept a commodity mentality. Be always ready to challenge that.
- Individualized information on consumer behavior can be the key to provide a customized offer.
- Fragmented consumer markets would offer a wealth of potential expansion.
- Unattended corporate customers can be enriched with knowledge transfer.

Who is the best customer?

- The one who receives the highest value added
- The one who has the most positive attitude towards you
- The one who you can serve most effectively
- The one with whom you can jointly define a unique, sustainable, differentiated value proposition.

If these conditions are met, that customer should also be the most profitable.