Target 'golden egg' consumer to achieve maximum ROI

Stop wasting money advertising to people who don't want your products, and focus on those who do; **Michael Lieberman**, Multivariate Solutions, explains how

GONE ARE THE DAYS when Henry Ford declared that customers could have their car in any colour that they wanted, as long as it was black. The 21st century consumer, used to choice in everything they buy, would ask: 'Which shade of black?'

The increase in customer choice is why we need segmentation. It is the process of classifying a marketing campaign into mini-markets that behave in the same way. The process consists of four basic steps:

- Identification
- Characterisation
- Evaluation
- Selection

If properly conceived, these segments will be homogenous in needs and attitudes. Customers in a segment will respond positively to the same communications strategy, marketing mix and services at the same pricing levels. That means more efficient marketing, industry structures, purchase funnel and customer satisfaction, all leading to more sales.

While cluster analysis – which provides the numerical split of the segmentation – is statistical, the initial segmentation of customers is a marketing process (Figure 1). This approach is routinely used in industries such as hospitality, consumer financial services, credit cards and online retail.

Waterfalls (so-called because one begins at the top of the consumer list and then tumbles down through a series of 'gates' to delve further into the customer base) and segmentations are key to direct marketing, improving responsiveness and the values of customer membership.

Larger communications strategies – such as Burger King's 'Have it Your Way' ad campaign – are typically employed after the segmentations are known.

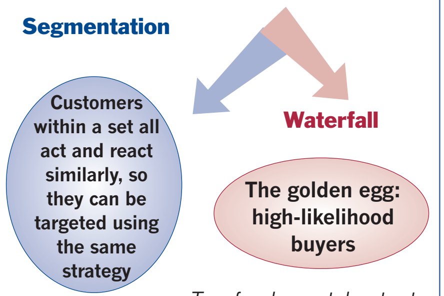
Retail magnate John Wanamaker's oft-quoted gripe that half the money he spent on advertising was wasted, but he could never work out which half, holds true when buying ads for luxury items, such as yachts. Perhaps the boat builder has a print ad that is not acted upon – even if it is admired – by 90% of subscribers to *Stinking Rich Quarterly*. However, the 10% who do respond to the advertisement and end up spending millions on a new yacht make the company a lot of money.

This means some of the dollars spent on advertising and sales efforts generate more revenue than others. In-depth data analyses are an effective way to reduce uncertainty and increase the efficiency of advertising spending.

The best way to illustrate this is through a case study to examine the benefits, actions and methodology involved in market segmentation and the creation of waterfalls. This is not the story of the Model T Ford, but of Delphine, a fictional women's fashion brand.

FIGURE 1

Segments and the waterfall



Two fundamental outputs from the two processes

Source: Multivariate Solutions

Delphine's tale

Delphine is a major women's fashion label carried by upscale department stores and a few direct Delphine retail outlets. A growing percentage of its revenue is generated by direct marketing through the Delphine catalogue and its online store.

So Delphine's marketing boss commissioned a major segmentation study, not only to redefine its core customers, but to assess brand equity. The brief was to go beyond the macro level and produce segment-by-segment micro-equities.

Delphine also sought the demographic and lifestyle make-up of its core customer. How much money do these devotees spend on a monthly basis, what share-of-wallet goes into the Delphine brand, how many of these top spenders exist, and how can the firm reach them?

In retail segmentation, identifying non-buyers is as important as identifying buyers, saving considerable effort in communication and messaging. In the Delphine screening, if the respondent was not female, didn't buy clothing or had never bought a Delphine product, they were thanked for their time and dismissed.

In a typical direct marketing business rules segmentation, each customer is scored on one of five 20% quintiles. The three 'RFM' quintiles are:

FIGURE 2

Customer segmentation

Delphine customer segments	$ spent monthly on clothing	Median monthly visits to upscale boutiques/stores	Percentage of sample
Delphine Superstars *Trendy dresser, 'it' woman, en vogue shopper, 'Delphine modern, sexy woman'*	$454	14	6%
Classic business dressers *Classic dresser, career woman, 'Delphine pretentious', money buys quality*	$336	6	15%
Eclectic independents *Urban dresser, independent woman, bargain hunters, 'Delphine fun'*	$125	3	28%
Low-probability shoppers *Casual dresser, wallflower, price, 'Delphine unoriginal'*	$60	1	51%

Source: Multivariate Solutions

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- How *recently* products were bought
- How *frequently* they are bought
- How much *money* was spent

However, given that Delphine's target audience is not only in the direct marketing category, but also retail and online, examination of this segmentation needs to focus on other measurements, such as wardrobe expenditure and the frequency of visits to top-end department stores.

Lifestyle and attitude arrays

Within the Delphine survey, four types of shopping and personality question were asked to find out how Delphine women define their clothing, their personal sense of confidence, their spending on clothes shopping and what wearing Delphine 'says about a woman'. Each of these produced an independent cluster analysis.

Cluster analysis is a statistical approach that organises similar customers into groups based on how they evaluate a number of variables. For Delphine, the chosen method of cluster analysis was a 'Q-Factor'. Factor analyses were performed on each of the four 'attitude arrays' in the Delphine questionnaire. Each one produced an independent cluster.

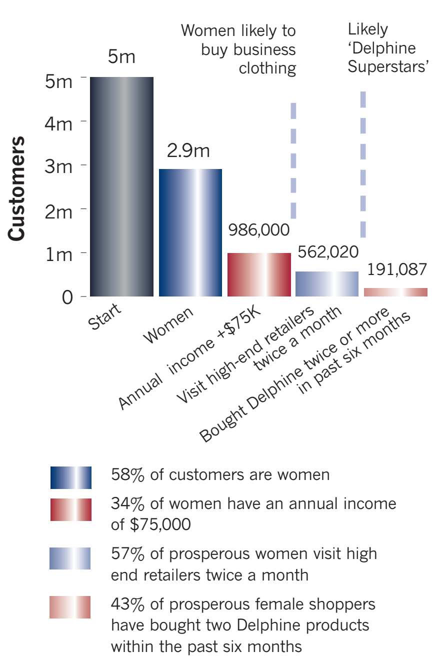
Once the cluster analyses were completed, the next step was to bind them, using a business rule. In this case, it was based on the amount of money Delphine purchasers spend per month on clothing and the Delphine image. This method is often referred to as a 'two-step'.

With these two business rules in mind, it is possible to combine and refine the five cluster analyses. Moreover, once the combinations were completed and the names of the segments listed, the characteristics of each segment emerged. Figure 2 summarises Delphine's customer segments.

Looking at the sample percentages, it became clear that Delphine's core customer was a fashionable, modern woman. The brand also appeals to the wealthy female business consumer who, while she might find Delphine slightly ostentatious, believes purchasing a product from the firm is good, if pricey, value.

FIGURE 3

Waterfall maximises ROI



Source: Multivariate Solutions

Predictive analytic approaches

After the Delphine segmentation was completed, the final segments were coded, and used to produce a banner of cross tabulations. This step was imperative, as it allowed Delphine's research department to understand the segmentation divisions and delve deeper into the data, the demographic composition of the target segments and the communications that resonated most effectively. Below are some of the key aspects of the survey which warranted further investigation:

- Share of wallet – Delphine
- Other brands purchased
- Key messaging by segment
- Demographics

The next step was practical application of the segmentation in a waterfall. The brand manager explored two approaches for Delphine to profit from the segments. The first was a fairly common back-classification. This can be accomplished using any number of predictive analytic approaches, such as discriminant analysis, CHAID, or logistic regression. Results can be placed into a classification worksheet or programmed as part of the questionnaire screening to pre-classify respondents for a future study.

Once its new segmentation model was in place, Delphine's next step was to use it to raise ROI from the distribution of its catalogue. The brand's marketing manager knew that, if Delphine shipped catalogues to high value consumers, the ROI would rise. The challenge has always been to find them, and segmentation provides a solution.

The key to a successful and efficient waterfall was to make decisions based on what the Delphine team learned about the characteristics of each segment based on the output of the segmentation.

The logistic regression provided a guide to which basic characteristics made the best 'gates'. These are commonly referred to as business rules.

Below are the business rules Delphine set for its waterfall:

- Female
- Annual family income over $75,000
- Visits high end retailers at least twice a month
- Has purchased two Delphine products within the past six months.

Examination of the data reveals that the percentage who get through the gates are roughly equal to the segmentation percentages (Figure 3).

At this point, Delphine's marketing director needed to make a business decision. Should the firm send catalogues to the 560,000 women likely to buy smart business clothing, or only to the 191,000 likely 'Delphine Superstars', out of a database of five million shoppers? This came down to a simple business calculation.

Once segmentation had shown the volumes of different groups, Delphine's board fed in the catalogue production and mailing costs, and came up with a point at which it got the maximum ROI.

More on customer segmentation at www.warc.com