



Demystifying Segmentation – Part 1

In the ever-frenzied CRM business arena, the growing plethora of experts and subsequent opinions continue to provide a wealth of information for marketers on **How to Create Success in CRM**. It would certainly appear that the marketplace cannot get enough information on this topic and is attempting to quench its insatiable thirst for knowledge by simply having more material written on this knowledge. If you are like me, I have reached the point where I can actually read the first couple of paragraphs and ultimately determine if it is worthwhile content or not. We seem to be at a juncture where there is an awful abundance of repetitive material with very little new insights or knowledge. This is not that surprising when we consider that the whole area of CRM is for all intents and purposes still in its infancy. Yet, huge amounts of money are being invested in this area and as a result, we are witnessing an explosion of consultants and experts who will attempt to fill this knowledge void.

I often get a chuckle out of self-help books with their so-called X amount of steps to success. Many of the pundits and experts have attempted to use this type of approach when writing articles on CRM. However, putting my cynicism aside, I do tend to agree with the experts that the initial step or key to successful CRM lies within the data. This implies that we need to understand our customers first and ultimately develop marketing programs around this understanding rather than the other way around. This is certainly true within an organization's initial foray into CRM. But how do we achieve this understanding? More importantly if it is our first time that we are attempting to do analysis, where do we begin?

In attempting to initially understand customers, the first step should be to segment customers. Although consultants will all agree on this first step, the approach to how we segment is where consultants will differ. The differences reside in the fact that there is a practical or pragmatic way versus a scientific approach to segmentation. Rather than adopt one approach versus another, the actual approach or correct approach will depend on the complexity of the given customer base. For instance, a bank's customer database containing one million customers may require a much more sophisticated approach than the retail customer database containing fifty thousand customers.

In adopting a course of action for segmentation, it is important to remember that old business adage of the KISS principle (Keep It Simple, Stupid.). This has tremendous relevance for the following reasons:

- Easier to understand
- Actionability and execution
- Ease of tracking

In developing any segmentation system, one needs to weigh the incremental benefits of the system versus its complexity. Complexity as we know will increase the challenge in facilitating understanding throughout the organization as well as our ability to both execute the system and track results.

Obviously, the first consideration should be the number of segments that should be created in a database. Some organizations have their customer database segmented into over 50 segments. In adopting or developing an initial segmentation system, a good rule of thumb is not to look at more than 10 segments. In keeping the number of segments to a minimum, we can acquire initial learning which may provide insights that either supports the increase or decrease of the current number of segments.

Some critics may argue that is too broad in terms of identifying the right number of customers for a particular program. However, the idea of a segmentation system is to develop a number of broad segments with specific models that could be applied to each system. Let's take a look at a schematic listed below which attempts to illustrate this point.

Segments	Models
New Customers	<ul style="list-style-type: none"> • Activation models • Retention models • Cross-sell models
Single Product Purchasers	<ul style="list-style-type: none"> • Retention models • Cross-sell models
Inactive Customers	<ul style="list-style-type: none"> • Reactivation models
Medium Value Growers	<ul style="list-style-type: none"> • Retention models • Cross-sell models • Up-sell models
High-Value Customers	<ul style="list-style-type: none"> • Retention models

In this above table, separate marketing strategies can be developed for each segment. Depending on the results of data analysis within each segment, a number of different marketing programs could be identified within each segment. Alongside these programs, we then develop models which would be specific in terms of optimizing results for that particular marketing program and segment. This type of approach whereby we integrate both our segmentation efforts and modeling efforts will yield superior solutions as opposed to looking at either a segmentation

solution or modeling solution independent of each other. As always, we can validate this approach by creating the following testing environment:

Segment	Control Communication	Test Communication
Current Segmentation System	Cell A	Cell B
Proposed Segmentation Scheme and Models	Cell C	Cell D

In this simplistic example above, we want to compare our proposed segmentation scheme versus the current segmentation system or status quo. The two key areas of segment and communication are the primary elements that will yield improved results in any proposed segmentation system. The list or segment component identifies the appropriate names for a given initiative while the learning from the proposed segmentation system will provide insights into how to communicate to these groups of names. The following matrix allows us to determine the impact of both the communication and segmentation in achieving improved results. Listed below is how we might answer the following types of questions:

Impact of Segmentation Scheme from a segment perspective: Cell A vs. Cell C
Impact of Segmentation Scheme from a communication perspective: Cell D vs. Cell C.
Impact of Segmentation Scheme from an ROI perspective: Cell D vs. Cell A.

In developing these segments, the next question becomes “How do we do it?” The approach or path taken in developing these segments will depend on whether or not we adopt a scientific approach or a business pragmatic approach or perhaps a combination of the two. In the next article, I will outline these approaches along with their strengths and weaknesses.

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