Market Segmentation, Target Market Selection, and Positioning

As described in the “Note on Marketing Strategy” (HBS No. 598-061), after the marketing analysis phase, the next stage in the marketing process consists of the following three steps:

- Market segmentation
- Target market selection
- Positioning

These steps are the prerequisites for designing a successful marketing strategy. They allow the firm to focus its efforts on the right customers and also provide the organizing force for the marketing-mix elements. Product positioning, in particular, provides the synergy among the four Ps (product, price, place, and promotion) of the marketing plan.

This note elaborates on each of the three steps.

Market Segmentation

Market segmentation consists of dividing the market into groups of (potential) customers—called market segments—with distinct characteristics, behaviors, or needs. The aim is to cluster customers in groups that clearly differ from one another but show a great deal of homogeneity within the group. As such, compared with a large, heterogeneous market, those segments can be served more efficiently and effectively with products that match their needs.

It is important that the segments are sufficiently different from one another. In addition, it is critical that the segmentation is based on one or more customer characteristics relevant to the firm’s marketing effort. A thorough analysis of the customers is essential in that regard. We can distinguish two (related) types of segmentation:

- Segmentation based on benefits sought by customers
- Segmentation based on observable characteristics of customers

In an ideal scenario, marketers will typically want to segment customers based on the benefits they seek from a particular product. That is, they will try to group customers based on their needs. Take the example of nonprescription drugs treating pain, inflammation, and fever. Market research
has revealed that people evaluate these drugs along two dimensions: effectiveness and gentleness. There are two basic segments, each valuing one of these dimensions more than the other. Thus, there is one segment that prefers an effective drug even if it has side effects, while the other segment prefers a less effective drug provided that it is gentler, that is, without side effects. The two segments represent benefit segments in that they are based on differences in consumers’ preferences or needs.

In practice, marketers tend to delineate segments based on some observable characteristics. Most often, marketers use consumer demographics (such as gender, age, and income), consumers’ geographic location, their lifestyles, or behavioral characteristics (such as usage occasions) to create segments. The motivation is clear. Segments created in such a way are easy to identify and address with a marketing message. It is important to realize, however, that such segmentation only works to the extent that it is correlated with benefit segments. In the previous example about nonprescription painkillers, it happens to be the case that older people tend to belong to the benefit segment that values the drugs’ gentleness, while younger consumers prefer potent drugs even if they have side effects. Age, therefore, is a good variable by which to segment the market in this case. Age groups are easy to target and, in this case, age strongly correlates with distinct consumer preferences.

In summary, segmentation requires the following steps from the marketer:

• Understand the benefits that customers seek.

• Segment the market and develop prototypical customer profiles based on the customer benefits.

• Find the observable variables (such as demographic characteristics) most likely to discriminate among the benefit segments to identify membership in specific segments.

The segmentation process may seem quite straightforward, but in practice it requires quite a bit of experience and creativity. One complication is that there can be multiple acceptable benefit segmentation schemes. In general, a satisfactory, actionable market segmentation typically requires multiple iterations and informed compromises from the marketer.

**Target Market Selection**

Target market selection involves evaluating each market segment’s attractiveness and selecting one or more of the market segments to enter. It is the next logical step following segmentation. Once the firm understands the structure of consumer demand, it has to decide which segments it wants to serve and how. In addition to a solid understanding of the customer, analyses of the competitive environment and the company are instrumental to the task of target market selection. The objective is to select segments in such a way that the firm maximizes its profit.

In the case of over-the-counter painkillers discussed above, there are two basic types of drugs competing on the market. One is based on aspirin (e.g., Bayer), and the other is based on acetaminophen (e.g., Tylenol). It turns out that aspirin is more effective but has side effects causing minor stomach irritation. Thus, it is natural for firms producing these different drugs to focus on the segments that best fit their products. In this case, target market selection is relatively simple. In other cases, more elaborate analyses may be required to choose the appropriate segments to serve.

The key to target market selection is understanding differentiation. It involves collecting and comparing data on the company and its competitors to evaluate which is most likely to succeed serving each of the identified segments. The process starts by collecting data for each firm in five areas:
Each of these five general areas can be divided into more concrete items. For example, in the “ability to conceive and design” category, the marketer may want to evaluate competitors’ research and development (R&D) capability (as reflected in the size and experience of the design group as well as the R&D budget), existing patents and copyrights, access to new technologies through third parties, and so on. Similarly, to assess a firm’s “ability to produce,” competitors’ production technology and capacity as well as flexibility may need to be evaluated.

Once the necessary data are collected, they can be synthetized into so-called competitor capability matrices. One matrix is needed for each segment. In each matrix, the detailed items of the evaluation areas are listed in the rows, and the relevant firms—including both the firm itself and its competitors—are listed in the columns. Each entry consists of a rating (say, on a 10-point scale) of the competitor on the item corresponding to the entry. This format allows the marketer to recognize patterns in the competitive environment and identify the segment (or segments) where his or her firm is likely to be the strongest player. If there are too many items in the rows (as is often the case), it is useful to replicate the matrix by listing only those items that represent critical success factors in the product category. This enables a more parsimonious evaluation of the situation.

It is important to recognize that this “differential advantage analysis” facilitates target market selection by pointing out the relative strengths (and weaknesses) of the focal firm, but it does not predict the competitive reactions the firm might face if it indeed decides to target a segment. Anticipating such reactions typically requires a careful analysis of competitors’ overall corporate strategies and their reputation or history for competitive behavior.

**Positioning**

In the “Note on Marketing Strategy” (HBS No. 598-061), positioning is defined as the marketer’s effort to identify a unique selling proposition for the product. It is arranging for a product to occupy a clear, distinctive, and attractive position relative to competing products in the minds of target consumers.

A good positioning statement answers three questions:

- Who are the customers?
- What is the set of needs that the product fulfills?
- Why is the product the best option to satisfy those needs?

In finding a desirable positioning, the firm has to consider, for each potential segment, how it would approach serving that group of customers and how it would want to be perceived by those customers. The answers should be based on a thorough understanding of the customer, the competitive environment, the company itself, and the conditions of the market in which it operates.
The Positioning Statement

It is typically helpful to formalize the considerations in a “positioning statement” that specifies the place the firm wishes to occupy in its target customers’ minds. One commonly used form is:

Our ___________________________ is  _______________________________________
(product/brand)    (single most important claim)
among all _______________________________________
(competitive frame)
because  _______________________________________
(single most important support)

The positioning statement is primarily directed to potential customers. It guides the development of the marketing plan—it is often said that “solving” the positioning problem enables a company to solve its marketing-mix problem. For example, if a computer company finds that a market segment with budgetary constraints prefers its products because they are significantly cheaper than competitive offerings, it could aim for a “no frills” product line, closely monitor its price advantage, emphasize the low price in its advertising, and employ a direct-to-consumer channel strategy that limits the markup on its products. Similarly, if a sports apparel firm understands that customers in its desired market segment buy products that make them feel like professional athletes, it could seek such endorsements from top-ranking athletes and use them in its advertising, emphasize innovative top-of-the-line products, primarily use a high-end sports retailing channel, and aim for a higher price point.

A firm’s desired positioning thus is the organizing force among the marketing-mix elements to ensure their synergy. It is also important for internal communication within the firm. It identifies the firm. For example, IBM’s famous claim “The solution to your problem is IBM” helped change the firm’s internal culture by teaching employees to be problem solvers for their customers.

Differentiation

As the above statement indicates, a good positioning reflects a competitive differentiation. That statement should go beyond clearly articulating to customers the benefits that the product fulfills—the product should also be clearly differentiated from competitive offerings. A firm will not want to introduce products targeted at needs already sufficiently served by competitors, as it could lead to an intense price competition and leave no profit to the firm. In this regard, it is useful to consider the two extreme types of differentiation:

- If all buyers agree that product A is better than product B, they are vertically differentiated. Consequently, if products A and B are sold at the same price, nobody will buy product B.
- If products A and B differ in ways independent of buyers’ overall judgments about their quality levels, they are horizontally differentiated. If A and B are sold at the same price, some people will prefer one, some the other.
A positioning strategy based on a horizontal differentiation uses the fact that consumers differ in their tastes. For example, in the category of passenger cars, some consumers like small cars, others like minivans, while still others like SUVs. Each of these groups consists of a relatively homogeneous set of people with similar needs. A firm pursuing a horizontal differentiation strategy should identify the group(s) whose need(s) are not sufficiently served by a competitor.

Vertical differentiation also exploits the fact that consumers are different but takes advantage of consumers’ differences in their willingness to pay for quality. In a pure vertically differentiated world, all customers (and potential customers) agree on the relevant dimensions of product quality. In the example of passenger cars, quality can be a combination of speed, comfort, and reliability. In addition, all customers prefer more quality to less. However, they differ in their valuation of quality. Staying with the example of passenger cars, most consumers prefer a BMW to a Ford, but only few can—or would be willing to—pay the price for the BMW. A firm pursuing a vertical differentiation strategy should position products to customers with a specific level of willingness to pay for quality that is not sufficiently served by a competitor.

In practice, in most product categories, marketers have the option to differentiate their products both horizontally and vertically. Creativity and marketing expertise plays an important role. Some skilled marketers may discover or “create” a set of needs among customers not yet served or tap into a market segment previously not regarded as a viable group of customers to serve. Some firms even completely change the paradigm of differentiation in a category, for example by moving the focus from performance to style, as in Swatch’s redefinition of the watches category.

Any element of the marketing mix can be the primary instrument of differentiation. Product attributes or features are often a key differentiator (think of the importance of packaging for environmentally conscious, or “green,” consumers, for example). Price can be a useful signal of quality and thus a tool for vertical differentiation. Place can bring critical advantages (examples are online distribution, where consumers can shop in the privacy of their own home, or vending machines, where products are available instantaneously and 24 hours a day). Promotion is an obvious tool to communicate to consumers to what extent and along what dimensions the product is different from alternatives.

The Role of Brands

Positioning and branding are inextricably linked. Brands can be thought of simply as nouns that marketers have introduced into consumers’ language to make product differentiation concrete. At a minimum, they want to assert that their offering is not like those of their competitors. When marketers call a fruit juice “Snapple,” for instance, they are asserting that it is worth noting some special distinctions between Snapple and all other fruit juices. Some of these assertions can be viewed as promises or pledges about attributes of the product. Other assertions may have to do with how Snapple users are differentiated from Cola users, or how Snapple-usage occasions are differentiated from other beverage-usage occasions. Most ambitiously, a brand can assert that it is the category. Perhaps the highest goal to which a brand builder can aspire is to have the noun that he or she has imposed on the language displace the natural language word (as in using Kleenex to denote facial tissue, or speaking of Fedexing a package or Xeroxing a document). However, not all brands come to mean what the marketers have intended, and many brands struggle to denote anything that the consumer finds worthy of notice.

The discussion on brand development is continued in the submodule on integrated marketing communications. Differentiation in the context of product policy decisions is explored further in the note “Principles of Product Policy” (HBS No. 506-018).