# Understanding customers and markets

MODULE 2 | 2.5 | STUDENT COMPANION

**A market** is an industry's organisations together with their buyers. **Market segmentation** divides it into groups of buyers whose characteristics, needs and behaviour are alike. Industry segments group the **products** on offer; market segments group the **buyers**.

## Five tests of a good segment

**Homogeneous**
Members are alike in attitudes, behaviour and finances

**Heterogeneous**
Clearly different from the other segments

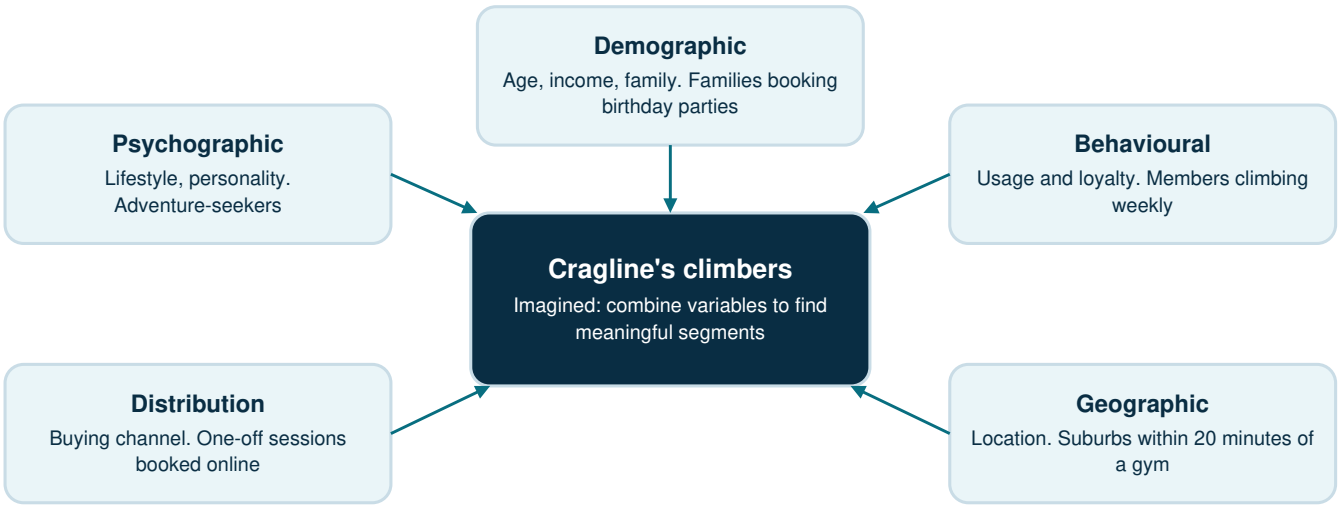
**Substantial**
Large enough, or valuable enough, to justify the effort

**Identifiable**
You can tell who belongs and who doesn't

**Responsive**
Members react in a similar way to what you offer

**Small can still be substantial: superyacht buyers are few, but each sale is worth a fortune**

## Five ways to segment a market



## Analysing a segment: seven questions

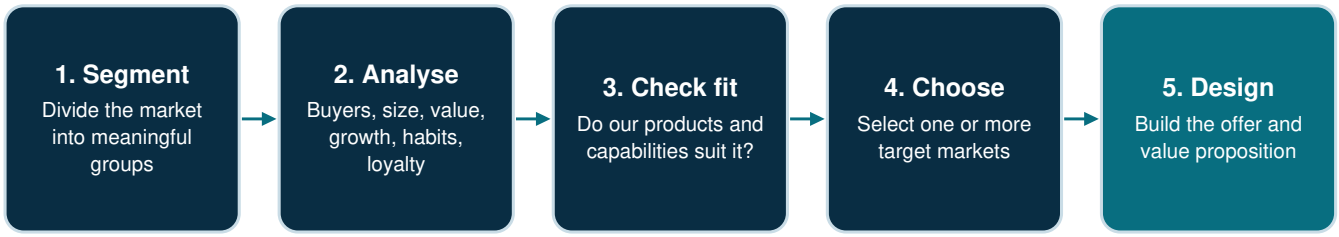
| Question | What to look for |
|---|---|
| Who are the buyers? | Characteristics, wants, needs, attitudes and behaviour; are they distinct? |
| How many are there? | Total sales or market share |
| What are they worth? | Contribution margin and profitability |
| How fast could it grow? | Growth potential |
| How do they shop? | Online or in store; regularly or occasionally |
| Do they stay loyal? | To the organisation, or to a product |
| Can we serve them? | Products, services and capabilities |

## Worked example: two Cragline segments (imagined)

Same contribution, very different segments. Casual visitors also feed tomorrow's membership, so the segments are linked.

| | Casual visitors | Committed members |
|---|---|---|
| Volume | 1,500 visits a month | 400 members |
| Price | $30 a visit | $90 a month |
| Variable cost | $10 a visit | $15 a member a month |
| Contribution a month | 1,500 x $20 = $30,000 | 400 x $75 = $30,000 |
| Reliability and loyalty | Rises and falls with holidays and weather | Paid monthly; loyal; bring friends |

## From segments to target markets




**Target many segments**
Spreads risk and fixed costs, but needs a wider range of capabilities

**Target one segment**
Builds deep expertise and loyalty, but exposed if that segment shrinks

**Start from what customers want, not from what the organisation happens to make**

## Case note: Toyota creates Lexus

By the 1980s Toyota had a strong reputation in the United States for reliable, affordable cars, but wealthy buyers seeking prestige bought German luxury brands. In 1983 Toyota began a secret project to build a car that could beat the world's best. Rather than sell it as a Toyota, it launched a new brand, Lexus, on 1 September 1989, with separate dealerships and a strong focus on quality and customer service. The flagship LS 400 was priced at about US$35,000, well below comparable German models, and by 1991 Lexus was outselling Mercedes-Benz and BMW as America's best-selling luxury import. Toyota identified a distinct, substantial segment, recognised that its existing brand and dealers could not serve it, and built a new offer and channel for that target market.

Sources: Toyota press release, 15 May 1989; Lexus Europe newsroom; Lexus USA newsroom, 'The History of Lexus'.

# Practice questions

MODULE 2 | 2.5 | TRY THESE BEFORE THE WORKED ANSWERS

## Question 1 - Test the proposed segments

Imagine **PulsePath**, a fitness app planning its marketing. Test each proposed segment against the five criteria.

| Proposed segment | Which tests does it pass or fail? |
|---|---|
| (a) People who like exercise | |
| (b) New mothers wanting short home workouts in the year after giving birth | |
| (c) People born in March | |
| (d) Office workers aged 25 to 40 in capital cities who want 20-minute lunchtime workouts | |
| (e) Elite marathon runners living in Hobart | |

## Question 2 - Segmenting a pet insurance market

Imagine **Pawsure**, a new Australian pet insurer. Choose at least three segmentation variables that would be useful, explain why, and describe three segments they would produce.

## Question 3 - Choose a target market

Imagine **Smokestack Roasters**, which sells coffee beans through its online store. Calculate each segment's yearly contribution, then recommend a target market and justify it.

| Segment | Customers or orders | Price | Margin | Growth | Loyalty and notes |
|---|---|---|---|---|---|
| A - Home espresso fans | 2,000 subscribers, 1 kg a month | $50/kg | 45% | 8% a year | High; subscriptions |
| B - Offices | 60 offices, 8 kg a month each | $40/kg | 35% | 2% a year | Medium; want machine servicing |
| C - Gift buyers | 3,000 orders a year | $45/order | 40% | 5% a year | Low; peaks before Christmas |

# Worked answers

MODULE 2 | 2.5 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

## Question 1 - PulsePath segments

| Segment | Assessment |
|---|---|
| (a) Like exercise | Fails homogeneous and identifiable: far too broad to design an offer around |
| (b) New mothers | Passes: alike in needs, distinct, substantial, identifiable, likely to respond to short home workouts |
| (c) Born in March | Fails responsive and homogeneous: birth month doesn't change what people want |
| (d) Office workers | Passes: clear needs (time), distinct, large and reachable |
| (e) Hobart marathon runners | Fails substantial: too few to justify a dedicated effort, unless very high value |

## Question 2 - Pawsure

- **Demographic (owner age and income):** young renters versus established families versus retirees differ in budget and cover needs.
- **Behavioural (pet type and vet usage):** owners of young dogs, older cats or pedigree breeds have very different claims patterns.
- **Psychographic (attitude to risk):** some owners want comprehensive cover for peace of mind; others want accident-only cover at the lowest price.
- **Distribution:** online direct buyers versus those who buy at the vet clinic.
- **Possible segments:** budget-conscious young owners of new puppies (accident and illness at low price); devoted owners of older pets (comprehensive cover, high value); multi-pet families (bundled discounts).

## Question 3 - Smokestack Roasters

| Segment | Yearly contribution | Comment |
|---|---|---|
| A - Espresso fans | 2,000 x 12 x $50 x 45% = $540,000 | Largest, growing fastest, loyal: best target |
| B - Offices | 60 x 8 x 12 x $40 x 35% = $80,640 | Needs machine servicing Smokestack lacks: a capability gap |
| C - Gift buyers | 3,000 x $45 x 40% = $54,000 | Seasonal and low loyalty, but cheap to serve online |

**Recommendation:** target home espresso fans as the primary market, with subscriptions and education to deepen loyalty; serve gift buyers as a seasonal secondary segment; avoid offices unless Smokestack builds or partners for machine servicing.