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Market segmentation and the structure of competition: applicability of the strategic group concept for an improved market segmentation on industrial markets

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Abstract

In recent years, many attempts were made to elaborate reliable segmentation concepts. However, even current articles on market segmentation focus only on customers. Competitors are at best accounted for once the segment formation is completed. And in contrast to customer analysis, the methodological consideration of competitors is rather superficial and unsystematic. In this respect, the current approach of market segmentation in theory and practice generally reflects the one-sidedness of marketing as criticized by Day and Wensley [Day GS, Wensley R. Marketing theory with a strategic orientation. J Mark 1983;47:79–89]. The authors claim that the results of segmentation could be improved considerably if information on competitors were considered in the process of market segmentation. A preliminary empirical test of the approach shows good support for the authors' hypotheses.

Keywords: Segmentation; Competition; Industrial markets

1. Introduction

Since Smith (1956) coined the term 'market segmentation,' the concept has received considerable attention both in marketing theory and practice. Although the approach was originally developed in connection with questions relating to the consumer market sector, it has found wide acceptance in the industrial market sector as well (for a general survey cf. Chéron and Kleinschmidt, 1985; Plank, 1985). Today, 'market segmentation' is a fundamental concept in modern marketing. Bonoma and Shapiro (1983, p. 2) refer to market segmentation as the "core of good industrial marketing." At the same time, they reach the conclusion that "conversely, many industrial marketing problems stem from poor market segmentation."

Therefore, it does not come as a surprise that in the past couple of years, many attempts were made to elaborate reliable segmentation concepts. It is striking, however, that even current articles on market segmentation—in the sense of formation and selection of customer groups—focus only on customers. Competitors are at best accounted for once the segment formation is completed. And in contrast to customer analysis, the methodological consideration of competitors is rather superficial and unsystematic. In this respect, the current approach of market segmentation in theory and practice generally reflects the one-sidedness of marketing as criticized by Day and Wensley (1983).

According to our view, the results of segmentation could be improved considerably if we could get away from an exclusive customer orientation.

1. The consideration of competitive structure provides additional basic information on segment formation.
2. The consideration of competitive structure facilitates the selection of promising segments.

In order to prove our thesis, we will proceed as follows. First, we will present the current state of market segmentation, especially with respect to industrial markets. Second, we will present a proposal, which includes competitive

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structure. We interpret the strategic group concept as a competitive counterpart to customer segments. Third, we will provide theoretical explanations of both approaches as a summary. Finally, we will put the present concept to a first empirical test using the elevator industry as an example.

2. Market segmentation on industrial markets: a brief survey

Bonoma and Shapiro (1983, p. 1) give an accurate description of the core of market segmentation:

> Segmentation is the process of separating a market into groups of customers, prospective customers (prospects), or buying situations such as that the members of each resulting group are more like the other members of that group than like members of other segments.

In the course of this separation, customers are grouped in segments who react to a concrete marketing mix with homogeneous buying behavior. The underlying hypothesis is that the benefits sought by customers are expressed by their buying behavior. Accordingly, a segment is defined as a group of customers who experience a similar problem and who react to market stimuli in the same way. For a firm, this means that different segments require different marketing activities. Such targeting can raise the prospect of success, i.e. the risk of wasting resources on customers who do not belong to the target segment will diminish.

The research results in organizational buying behavior studies are of particular importance to the industrial market sector. In principle, all factors of organizational buying behavior can be applied as segmentation criteria. This holds for the characteristics of the purchasing organization, the structure of the buying center, the buyclass, or for the situational factors influencing the buying process.

In addition to this behavior-oriented explanation of market segmentation, a theoretical foundation of market segmentation is also derived from micro-economics (cf. Frank et al., 1972, 177–185). More than 60 years ago, Robinson (1948) explained that a salesperson has the possibility to divide the market according to various demand elasticities, making price the only marketing instrument. Chamberlain (1947) concentrated on two additional marketing instruments. Profits can be maximized by product differentiation and the application of "selling costs" like advertising, sales promotion, and a profit margin for retailers and wholesalers.

Excess of supply over demand motivates the practical application of segmentation concepts. It demands that suppliers "have to be better," meaning that they must meet customer needs to a higher degree. Market segmentation with its informative and structuring function qualifies for this requirement. In accordance with this, Kotler regards market segmentation as the notion of the modern "marketing concept" that allows market compulsions to be met by higher benefits for each customer. Once again, this reflects the lack of symmetry apparent in the study of customers and competitors, which is symptomatic for marketing science. In this definition of the marketing concept, Kotler (1988) demands that the customers' needs have to be recognized and satisfied more efficiently and more effectively in relation to the competitors. Nevertheless, this is not expressed explicitly in the different approaches to market segmentation.

If competitor orientation is neglected, the assessment of segments or segmentation criteria using largely accepted requirements for market segments—like customer response, measurability, accessibility, substantiality, and temporal stability (cf. Frank et al., 1972, 27f.)—can lead to disappointing results, since it cannot be stated that a segment fulfills the requirements without the consideration of actual and potential competitors: competitive behavior has a significant effect on the substantiality of segments and on their temporal stability.

3. The strategic group concept as a foundation for a competitor-oriented expansion of the segmentation of industrial markets

The competitor-oriented expansion of market segmentation suggested here falls back upon approaches of industrial organization (Bain, 1956, 1968; Mason, 1957; Scherer, 1980). Recent developments, which overcame the restrictions of traditional industrial organization, are particularly fruitful: The strategic group concept accounts for the empirically determined heterogeneity of suppliers within an industry. Hunt's (1972) pioneering work in this area was succeeded by further studies. Porter (1980), however, was the first one to popularize the approach in his well-known book "Competitive Strategy."

A strategic group is a set of firms or business units which pursue the same or a similar strategy with respect to central strategic dimensions (cf. Caves and Porter, 1977; Porter, 1980). Porter points out that the affiliation to a group does not reflect complete homogeneity. Strategic grouping is rather to be interpreted as an analytic tool (Hatten and Hatten, 1987). In this respect, a strategic group forms the "smallest common denominator" of similarity in competitive strategy. On the one hand, it is possible that the firms of a market form a single strategic group. On the other hand, in an extreme case, strategic groups could consist of only one member, with each firm following its individual strategy.

The meaning of the group concept results from the empirically determined recognition that single groups are separated by barriers which restrict the strategic mobility of suppliers (Caves and Porter, 1977). Porter (1980, 133f.) defines these mobility barriers as "factors, that deter the movement of firms from one strategic position to another."