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Customer segments as moving targets: Integrating customer value dynamism into segment instability logic

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Abstract

Segmentation is a mature concept in marketing strategy that continues to receive significant attention from managers and scholars alike. The key goal in segmentation is identifying and reaching profitable segments with products and services that meet the common needs of these customers. However, a fundamental issue needing rigorous attention is that customers' needs are dynamic and can induce segment instability. The purpose of this paper is to draw focus to segment instability in business-to-business markets by conceptually exploring its theoretical underpinnings and integrating related theory on customer value change to propose an agenda for future research.

Keywords: Customer value change; Segment instability; Industrial segmentation; Changing needs

1. Introduction

Segmentation has been called one of the most important concepts in marketing (Dickson, 1982), based largely on its capacity to serve as both a strategic lens for managers and a tool to break down markets into customers grouped by common needs (Freytag & Clarke, 2001). Skillful segmentation equips firms to target profitable customers, understand customers' desires, allocate resources, and position against competitors (Beane & Ennis, 1987; Berrigan & Finkbeiner, 1992; Tapp & Clowes, 2002). Yet, despite decades of research, scholars suggest that the discipline of segmentation has a long way to go theoretically and methodologically (Bolton & Myers, 2003; Steenkamp & Hofstede, 2002; Wedel & Kamakura, 2002a). This is especially the case in business-to-business markets and global contexts (Steenkamp, 2005; Sudharshan & Winter, 1998).

The key challenges facing segmentation solutions are summed up by established criteria, which require segments to be: (1) measurable, (2) substantial, (3) accessible, (4) actionable, (5) responsive, and (6) stable (Kotler, 1994; Wedel & Kamakura, 2002b). Researchers have also discussed barriers to implementation (Bottomley & Nairn, 2004; Dibb & Simkin, 2001), but problems in segmentation frequently correspond to one or more of these six requirements.

Dealing with the sixth requirement is a difficult challenge that scholars refer to as *segment instability* (Farley, Winer, & Lehmann, 1987; Hoek, Gendall, & Esslemont, 1993; Hu & Rau, 1995; Steenkamp & Hofstede, 2002; Wedel & Kamakura, 2002b). Specifically, researchers indicate that markets are becoming increasingly dynamic (Barnett & McKendrick, 2004; Douglas, 2001; Eisenhardt & Martin, 2000; Voelpel, Leibold, Tekie, & Von Krogh, 2005) and "customers' changing needs" and "rapidly evolving preferences" represent key drivers of this market turbulence (Achrol & Etzel, 2003; Achrol & Kotler, 1999; D'Aveni, 1995; Joshi & Campbell, 2003). One important consequence of rapid changes in customers' needs is that they can render a firm's target segments unstable. Although both consumers and business customers' needs are dynamic, scholars suggest that segment instability is more pronounced in business markets, which can be more sensitive to ongoing changes in macro-economic conditions (Dickson, 1994; Mitchell & Wilson, 1998).

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As business markets evolve, customers' changing needs can induce segment instability in two important ways. First, what is valued by individual business customers in a segment (i.e., desired value) may change, reflecting what has been termed customer desired value change (CDVC) (Flint, Woodruff, & Gardial, 1997, 2002). For example, a business customer that decides to expand its operations internationally may begin valuing new types of supplier benefits, such as having a global account team, and no longer be adequately served by a supplier's offers targeted for a domestic segment. When CDVC is widespread, the needs of a segment's customers (over time) can diverge from the segment's originally defined properties and weaken customers' responsiveness to offers (Wedel & Kamakura, 2002b). Second, when customers undergo changes in what they value from suppliers, they may move into or fall out of a firm's target segment, resulting in size dynamics, i.e., the quantity of customers and revenue in a segment increasing or decreasing.

The intensity of CDVC can be low for some customers that experience relatively few changes in what they value from suppliers and, thus, remain in a segment for a long time. Industrial customers purchasing commodity products for use in mature manufacturing processes (e.g., chemicals company purchasing raw materials) might reflect fewer changes in their needs and desired value. CDVC can be high, for example, in situations where customers are outsourcing business functions (e.g., IT infrastructure) and customers' understanding of their needs and the available solutions are continually changing. The software sector is one illustration of a product-market where business customer needs are changing rapidly, given that a number of firms are closely considering how developments in open-source code (e.g., Linux) and software-as-a-service (e.g., salesforce.com business model) might fit their evolving business needs (Hamm, 2006).

The more extensive segment instability (SI) is, the more costly it is for suppliers (Mitchell & Wilson, 1998; Plank, 1985). One significant cost can be lost customers. Simply retaining an additional 5% of customers can translate into millions of dollars for many firms (Reichheld, 1996). Yet, sometimes customers leave because their needs have changed and they no longer derive sufficient value from existing offers (Beverland, Farrelly, & Woodhatch, 2004). Thus, it is critical that marketing managers understand more about segment instability. In order to assist managers in this regard, theoretical exploration of SI must also move forward quickly (Mitchell & Wilson, 1998; Steenkamp, 2005; Wedel & Kamakura, 2002a). Yet, recent reviews suggest it is not moving quickly enough (Steenkamp & Hofstede, 2002). Some advocate that more theory development exploring the dynamic nature of customer value perceptions is an important next step (Brangule-Vlagsma, Pieters, & Wedel, 2002; Flint et al., 2002).

Thus, the purpose of this paper is to explore the theoretical roots of SI and integrate related concepts addressing changes in customers' desired value and needs to propose an agenda for future research. Our initial question is what are the likely characteristics of segment instability, including the way it occurs, as well as its drivers and outcomes? Several steps are taken to address this question. First, we examine relevant segmentation research and offer a conceptual definition of SI. Second, we present a review of previous studies dealing with SI and integrate key perspectives on customer change. Last, we put forth a theoretical framework of SI and an agenda for research.

2. Segmentation theory

Theory development in industrial segmentation has received far less attention than consumer segmentation and, in recent years, has proceeded slowly (Goller, Hogg, & Kalafatis, 2002). One explanation for this slow growth might relate to questions about the relevance of business segmentation (e.g., Dibb, 2001) in light of increasing interest in marketing to individual customers, using customer lifetime value models (CLV) and database marketing strategies (Kumar & Petersen, 2005). However, recent empirical research shows that these strategies lead potentially, but not necessarily, to greater profitability. Furthermore, the difficulties in predicting CLV can weaken results (Malthouse & Blattberg, 2005). Other scholars suggest that the use of database marketing does not preclude the significant scale advantages that can be obtained through segmentation, but rather that the two strategies should be used in tandem (Steenkamp & Hofstede, 2002). Thus, calls for more theory development in segmentation seem justified (Wedel & Kamakura, 2002a).

Recent reviews focus on organizational barriers to segmentation, methodological approaches, and poor results in segmentation practice as weak areas within industrial segmentation (Dibb & Simkin, 2001; Goller et al., 2002; Wedel & Kamakura, 2002b). What research shows is that many firms are more concerned with identifying customer groups that coincide with existing marketing programs than employing systematic processes to uncover segments that draw meaningful distinctions between customers (Dibb & Simkin, 2001). Methodologically, two weak spots include the need for empirical testing of the predictive validity of segment solutions and more frequent model comparisons to identify conditions where certain models provide the best representation of business markets (Wedel & Kamakura, 2002b).

Conceptual discussion is particularly lacking in regard to segment instability, where comments are often limited to noting the inconsistency of segment solutions over time. Thus, the following section highlights relevant foundations to ground SI in existing segmentation theory.

2.1. Heterogeneity of needs in the market

Segmentation theory stipulates that customers' needs, preferences, or desired value dimensions are heterogeneous, (i.e., they vary greatly) and this diversity can be captured using variables that discriminate among these different needs (Beik & Buzby, 1973; Day, Shocker, & Srivastava, 1979; Freytag & Clarke, 2001; Green & Krieger, 1991; Smith, 1956). Firms capitalize on need heterogeneity by identifying meaningful clusters of customers that have relatively homogeneous sets of needs. Despite considerable extensions, exploration of variables, and an abundance of research on the topic, the essence of segmentation theory for nearly 50 years has been this notion of *customer need heterogeneity* (Smith, 1956; Wedel & Kamakura, 2002a).