Industry Segmentation Template

Prepared by Stefano Messori, this document is intended as an accompaniment to the *Industry Segmentation MS Excel spreadsheet*. The spreadsheet, which is available as a free download (now also unlocked), was developed on the basis of Michael E. Porter's framework for industry segmentation. Outlined in this document are the instructions for the use of the spreadsheet and the basic materials needed to perform a segmentation of your industry, thereby providing a foundation to help you identify the segments present in your industry and to develop new segmentation approaches.

My first three templates **concentrated on your industry**, analysing the competition present in it at three different levels.

- In the industry analysis template we examined competition within the industry as a whole.
- In the competitor analysis template we analysed competition focusing on each of your competitors separately.
- In the company positioning template we studied the competition present in the different strategic groups present within your industry.

With this new template **the focus shifts from your industry to your firm**, and the various activities that it performs. The application of this template requires a basic understanding of the **value chain**, a framework for thinking strategically with regard to the different activities that your company performs and the role these activities play in the creation of your competitive advantage, whether low cost or high value.

Industry segmentation v market segmentation

Many companies develop a segmentation approach based merely on the different marketing activities required to better service one particular market segment. This modus operandi is ultimately limiting as it focuses solely on marketing activities, ignoring all of the other activities along the company value chain. Industry segmentation on the other hand encompasses the entire value chain, and will help to explain how the different activities that your company engages in determine your ability to serve a particular segment within your industry, and the difficulties potentially arising from seeking to serve different segments simultaneously.

This expanded perspective of the activities that your company performs is fundamental to developing novel segmentation approaches as a possible basis for new competitive advantages.

1) Basis for industry segmentation

An industry segment is a combination of product varieties and a corresponding group of buyers.

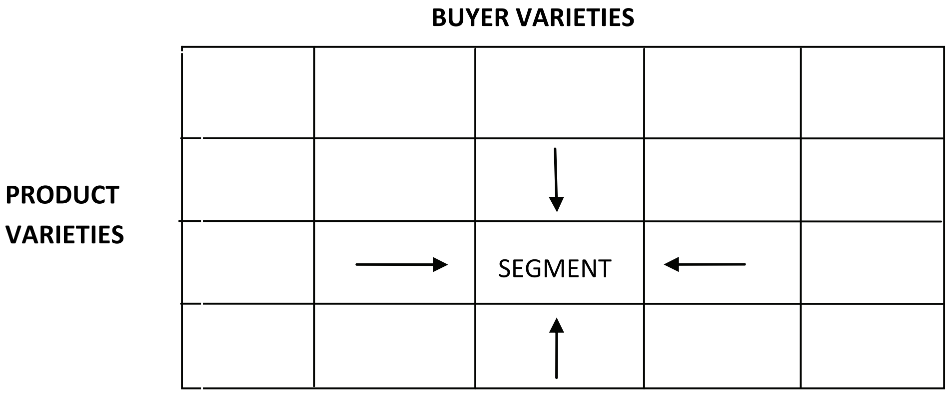

Figure 1: An industry as a collection of product and buyer segments

Industry segmentation is a necessary step in the formulation of a successful strategy because the products and the buyers in your industry may differ substantially in terms of their requirements. As a consequence, your company's ability to serve them can vary significantly.

The segmentation of an industry is based on two main factors:

- **The attractiveness of a segment:** structural differences between the products / buyers in your industry create an industry segment if they alter the balance of the five competitive forces at the segment level.

- **Value chain differences:** differences between products / buyers in your industry create an industry segment if they affect the requirements for competitive advantage.

It is necessary to define industry segments independent of your industry competitors. Furthermore, the ability to perceive segments within your industry based on structural differences that competitors have not yet spotted is a source of competitive advantage. Industry segmentation should include potential new product varieties and buyer groups as well as those that already exist.

1.1) Segmentation variables

There are four main types of segmentation variable that can be used to underline the differences between the various products and buyers present in your industry:

product variety → **product-related variable**

buyer type
channel
buyer location } **buyer-related variables**

Identifying segmentation variables is perhaps the most creative part of the industry segmentation process. Your job is finding the dimensions along with the **product** and **buyer differences** that generate the most important **structural** or **value chain disparities** between the firms competing in your industry. This job requires a good understanding of your industry structure and your buyers' value chains.

At this point you should fill in the accompanying *MS Excel spreadsheet* before continuing.

2) Building an industry segmentation matrix

The industry segmentation matrix is a basic tool that allows you to translate the most relevant variables into a real segmentation of your industry.

2.1) The fist step is to select the relevant **segmentation variables** with structural or value chain implications. The overall difficulty of the segmentation process depends on the number of relevant segmentation variables to be selected.

2.2) The second step is to apply a **significance test to each segmentation variable.** Only those variables with a truly significant impact on the sources of competitive advantage or industry structure should be isolated for strategic analysis.

2.3) The third step in segmenting your industry is choosing a number of **categories for each segmentation variable you have selected.**

Some possible **buyer segmentation variables** and corresponding categories include:

- **size**, and the categories *major, large* and *small*;
- **level of sophistication**, and the categories *sophisticated* and *unsophisticated*;
- **type of ownership**, and the categories *private* and *public.*

Possible **product variety segmentation variables** and the corresponding categories include:

- **physical size**, and the categories *large, medium* and *small*;
- **price level**, and the categories *premium* and *discount*;
- **type of product / service**, and the categories *bundled* and *unbundled*.

These categories should capture the most significant structural or value chain differences, bearing in mind the need to balance this against the practical need to limit the number of segments to a feasible amount. Please refer to the *MS Excel spreadsheet* for suggestions with regard to categories.

BUYERS
(segmentation variable 1)

Category

BUYERS (segmentation variable 2) Category

	1	2	3	4	5
1					
2					
3					
4					

Figure 2: Buyer segmentation matrix as a combination of segmentation variables

2.4) The forth step is to plot segmentation matrices for each pair of homogeneous variables belonging to the:

- product segmentation variables and
- the buyer-related variables (buyer type, channel, geography).

This makes it possible to identify and eliminate nil cells.

BUYERS

Category

BUYERS Category

	1	2	3	4	5
1	Nil				
2			Nil		
3	Nil	Nil			
4	Nil		Nil		

Figure 3: Nil cells represent an unfeasible combination of segmentation variables

Eliminate nil cells if they represent an **unfeasible combination of your segmentation variables**, but not if they are merely cells in which there is no firm in your industry currently operating. Feasible yet unexploited segments represent a potential opportunity for your company and it is important that you focus on such segments rather than eliminating them from your matrix.

2.5) The fifth step is to **reduce the number of matrices that you have built.** This means **reducing the number of segmentation variables** through **collapsing correlated variables into one another.** Segmentation variables that are highly correlated can be combined, because one variable is a surrogate for the effect of the other.

For example, take a matrix composed of the two following segmentation variables:

- **buyer sophistication** on one axis and
- **buyer size** on the other axis.

You can collapse these two variables into a single segmentation variable called **buyer sophistication and size.** This process is also facilitated by the elimination of nil cells.

It is important to understand why variables are related, because this will often have important ramifications.

2.6) The sixth step in segmenting your industry is to **combine the remaining segmentation matrices.**

To obtain just a single segmentation matrix you have to create a matrix featuring:

- one axis reflecting the combined **product segmentation variables** and
- the other combining all of the **buyer-related variables** (buyer type, channel, geography).

BUYERS
(combination of buyer, channel and geography segmentation variables)

Category

PRODUCT VARIETIES
(combination of product variety segmentation variables)

Category

	1	2	3	4	5
1					
2					
3					
4					

Figure 4: Final industry segmentation matrix as a collection of product and buyer segments

This matrix may be quite large, but has the advantage of displaying the entire industry in a way that facilitates strategic analysis. The industry segmentation matrix should contain **potential segments** and not just segments that are currently occupied. Potential segments may imply entirely new segmentation variables or new discrete categories of existing variables.

2.7) The last step is to **test your segmentation matrix by examining the strategies of your competitors**. If the scope of your competitors' activities is plotted on the matrix, new segments or segmentation variables may be exposed. Conversely, a matrix of your competitors' activities may also highlight segments that must inevitably be served by you and your competitors.

3) Conclusions

Industry segmentation is a basic tool to identify the different segments present in your industry as well as the possible new segments. Your task is to understand how the activities that your company performs provide you with the sustainable competitive advantage you need to serve your target segment.

The key strategic questions that arise from segmentation are:

- Where in the industry should my firm compete?
- How should my strategy reflect this segmentation?

Your firm can adopt a broadly-targeted strategy that addresses many segments, or it can exclusively address a small number of segments as part of a focused strategy.

Segmentation is a dynamic process; a process occurring at different speeds in different industries. Therefore, you should apply this framework on a regular basis as your company needs to continually be aware of how new segmentation approaches may lead to structural changes in your industry, and recognise how to take advantage of them.

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Stefano's mission is to restore the connection between local communities and the enterprises working in them by…

- …enhancing strategic thinking within companies, organisations and institutions.
- …reinforcing the idea of a 'win-win game' between businesses and local communities.
- …expanding the value proposition of businesses, introducing social and environmental factors as a central part of their agenda.

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