Strategic Segmentation – The Preamble of Developing a Company Strategy

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Abstract

The financial and economic crisis that the world economy has experienced, more than any other disturbing factor, we believe that it must cause a brutal rupture of the daily routine of the companies regarding their strategic management approach.

A first consequence of the crisis-strategic management report within a company is a need for its coherent strategic approach that would ensure the possibility of exceeding the current context and ensuring the necessary performance in the tough competition to follow. In this context, a relevant strategic segmentation of the portfolio of activities of the company and its analysis are essential initial aspects of this work.

In this article based on research conducted in several national and international companies we will adress the key issues of strategic segmentation, identifying the errors to be avoided.

Keywords: *strategic segmentation, key success factors, strategic segmentation criteria, strategic segments.*

JEL classification: D24, L21, M21, M31, O12

Introduction

As it is well known, the strategic analysis of a company requires a diagnosis of the external environment (the strategic analysis of the competitive environment) and a diagnosis of internal environment (the internal strategic analysis of the company). What is less known is that the two diagnoses cannot be made at the level of the whole company, a strategic segmentation activity being imperative.

Strategic segmentation is a very complex endeavour and one cannot speak of either a scientifical method or an exact science in this respect. It is the preamble of any study of strategic analysis, being different from market segmentation (from marketing), strategic segmentation including the latter.

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1. Strategic segmentation content

Strategic segmentation will allow company management to have a truly strategic vision of it, giving it the opportunity to perceive the company not as a whole or as a simple sum of divisions, but as a group of determined strategic activity segments taking into account several strategic variables. This new approach represents a way of highlighting strategic issues regarding the operation of the company. In order to face competitors and have chances of success, the company will have to define its chosen competitive advantage especially at the level of each strategic activity segment and by allocating necessary resources (at the level of the whole company), in order to build and strengthen it, it will create necessary prerequisites for achieving the fundamental objectives at the level of the whole company. But in order to build the competitive advantage in each strategic activity segment, the company management must understand and explain as clearly as possible the exact conditions of the ”competitive struggle”, an aspect which has to determine the key success factors in each strategic activity segment.

Reflections on competitive advantage are now less dogmatic, accepting the idea that it results from a multitude of factors (without stressing the great importance of one or the other) At this stage of fierce competition, when companies have minimized costs, greather attention is paid to differentiation, considered their chance of survival but differentiation in our opinion, does not necessarily imply the dominance of the sector through quality, according to M. Porter (Porter, M.E., 1985). Jack Trout stresses the need for a company to identify those ways through which it can truly differentiate, highligting: an atribute or a feature, a specific feature or a product; being the leader as it is considered by the author as the most powerful way by means of which one can differentiate a brand; tradition, which has the power to highlight your product; specialization in a specific activity or product, something that gives the company the expert quality; how a product is made or that "magic ingredient" that a product incorporates and that distinguishes it from the competition; the ability to position the brand as a new and better one , with emphasis on the "new" side etc. (Trout, J., 2005, p. 45).

While developing a company strategy, the first strategic decision taken refers to the correct definition of its strategic activity segments. We believe that any strategic approach is doomed to failure, as confirmed by the economic reality in the context in which it deals with the company as a whole and not as an entity of strategic activity segments, grouped by the homogeneity of the key success factors, or in case the strategic activity segments are not set correctly. We believe that a strategic analysis of a company's competitive environment, a strategic internal diagnosis, a SWOT analysis performed at the level of the whole company (approaches that unfortunately we encounter frequently) will not be helpful for the company management in formulating a relevant strategic approach in the absence of a right strategic segmentation.

It is believed that strategic segmentation is one of the most critical and difficult stages of the strategy development on it depending the identification of competitors starting from the specific needs of the market, a strategic approach adapted to the defined segment functional and adopting some policies at company level aimed to enable the implementation of the adopted strategic approach. (Thietart, R.A., Xuereb, J.M., 2009, p. 59) At the same time, it ensures the coherence of the current tactical and strategic decisions and a better coordination of all operational and functional departments within the company to achieve strategic objectives. (Popa, I. 2004, p. 80).

Most companies do not offer the market a single product, but offers a product line, something that raises the question of establishing their interdependence regarding the demand, with direct impact especially on pricing, but also in terms of manufacturing, production and sales technology, with particular impact on correct establishment of strategic segments.

Strategic segmentation can be defined as an approach which brings together basic activities of the company, after the homogeneity of the key success factors aiming at the ”market – product – technology” trinomial. (Corbos, R.A., Zamfir, A., Forea (Ionescu), A.I., 2013, p. 360)

Strategic segmentation has two major purposes:

- √ to identify different groups of activities that structure the company, in terms of opportunities for strategic action;
- √ to assess the structural and procedural organization and the strategic information system, in terms of coherence and complementarity that must exist between the various segments identified between them and the overall organization of the company.

Strategic segmentation is different from market segmentation (from marketing), although it is based on the latter, in the sense that strategic segmentation includes market segmentation. Thus, if market segmentation identifies the market segments to be satisfied by a company, strategic segmentation identifies operating segments that meet specific market segments (one or more) (Cârstea, Gh. etc. 2002, p. 50).

Market segmentation is based on criteria resulting from shoppers' behaviour, the evolution of supply and demand and the competition, while strategic segmentation in the addition to these criteria is based on:

- ➢ value items for the buyer;
- ➢ sources of competitive advantage;
- ➢ the sharing of technological resources and cost.

A strategic activity segment (SAS) is a set of one or several product lines, having the same technology, the same resources, in order to face the same competitors in the same market and based on the same key success factors. (Deac, V., ed., 2014, p. 65)

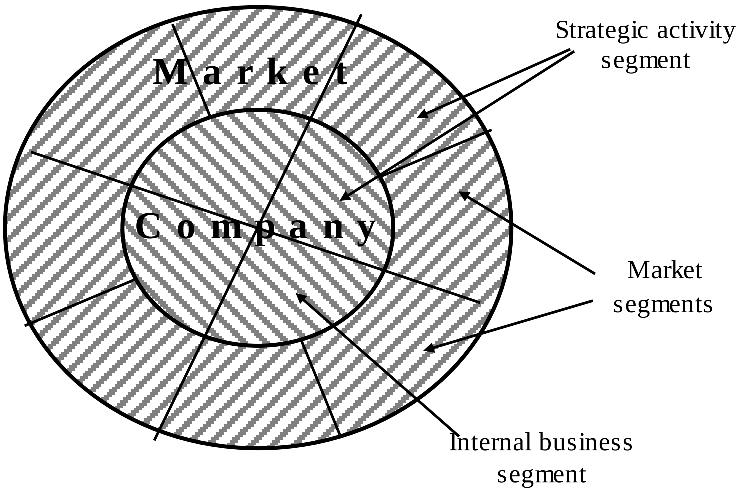

Figure 1. Market segments – Strategic activity segments

In order to face competition with chances of success, a company will have to define the chosen competitive advantage for each SAS, and for this it is vital to understand and clearly explain the precise conditions of competitive struggle, namely to determine key success factors at the level of each strategic activity segment.

Key Success Factors (KSF) are elements on which competition between competitors takes place with priority and genuinely, they are skills, strengths that an organization holds ensuring it a competitive advantage in the fight with the other competitors. For this reason, being confirmed by the economic reality, KSF determination is a first step in strategic segmentation. They have to be formulated clearly, concisely, unambiguously, avoiding mistakes, frequently encountered in economic practice, but unfortunately in some theoretical works as well, namely confusing cause and effect (eg. "a better customers' needs satisfaction" is an effect and cannot be a KSF, but the cause of this effect, for instance "the adaptability to customers' needs can be a KSF). As possible KSF met in the economic reality we highlight various positive elements regarding the following aspects: price, costs, delivery, quality, reputation, image, adaptability to customer's needs, advice ability, demonstrations to clients, administrative logistics, breadth of product range, research and development capacity, innovative contribution, sales flexibility, sales force, reliability, packaging, transportation, after-sales services, etc.

The mere enumeration of possible KSF gives the impression that they usually result from the "market - product - technology" trinomial**,** the company in question being exclusively involved, an erroneous impression, for example, developing partnerships with suppliers of materials, since the very research and development phase of new products (such as the automotive manufacturing and aerospace industries, which were the first that involved suppliers in new product development, due to the complexity of parts, equipments and technological processes), will have as consequences lower production costs, a shorter period for product designing and manufacturing, a higher product and process quality, aspects that can represent elements of competitive advantage (Cârstea, Gh., Păun, O., 2014, p. 42)

2. Strategic segmentation criteria

Strategic segmentation is a very difficult operation, based on the use of criteria which chosen incorrectly, may lead to false strategic activity segments, without a strategic impact on the company.

In a practical approach to strategic segmentation one has to consider a number of strategic segmentation criteria or variables. These criteria or strategic segmentation variables will allow, in most cases, making an initial strategic segmentation, indicating that they should be judged by the characteristics of a certain field of activity and based on these characteristics one may also consider other criteria.

In this paper, based on various criteria or strategic segmentation variables shown in the literature (Garibaldi, G., 2009 p. 221), we will try to highlight any possible errors that might make a concrete strategic segmentation approach, with a severe negative impact on strategic decisions after this endeavor:

a. Homogeneity of the activities defining a strategic segment.

Most companies do not offer the market a single product, but offers a product line, something that raises the question of establishing their interdependence regarding the demand, with direct impact especially on pricing (Simon, H., Jacquet, F., Brault, F. 2006, p. 209), but also in terms of manufacturing, production and sales technology, with particular impact on correct establishment of strategic segments.

This also applies to common or distinctive aspects of different product lines of the company within the sector of: research & development – design – production – sales – after – sales service. Considering this criterion, for example, activities that are different in terms of skills required will not be included in the same segment strategic (both specific skills and especially basic skills, namely those very rare or unique assets that a company holds in the respective strategic activity segment), the investments involved, synergy, manufacturing, marketing, etc.

For example, all the issues listed above are totally different when a company produces the entire product compared with the situation when for another product the company executes only the fitting. The two products cannot be part of the same strategic segment.

If we take the example of Adidas that produces sports goods it would be a huge mistake to include both sportswear and sport shoes in the same strategic segment. The two product lines using completely different technologies will be included in distinct strategic segments, although they satisfy the same type of needs, they target the same markets and the competitors are identical.

b. Specific market. One considers whether the products of the same line are for the same specific market or not. For example, the same line of products, solvent-based paints, may target the professional market (car manufacturers) or the consumer market. Each of these markets has its own operation mode, its use of the products, their own buying criteria, their own modes of supply, etc.. Therefore, it is not pertinent to include markets with distinct characteristics in the same SAS.

c. Distribution system. Considering the analysis of various distribution networks through which various product lines reach the customer or end user. Each distribution network has its own KFS. For example, in the case of direct sales the indispensable qualities are mainly the ability to manage and motivate an efficient sales force (direct agents), compared to situations in which the distribution is made through a network of hypermarkets, through exclusive distributors or not, by mail, by courier, situations involving different skills and KFS.(Deac, V., Vrîncuţ, M., Păun, O., 2014, p. 136)

Therefore, it is unfair to include in the same SAS product lines sold through distribution ways characterized by different skills (only distribution ways that require the same skills will be grouped in the same SAS).

d. Shared experience base. Variables related to this criterion allow consideration of specific aspects of product lines in relation to others. This specificity may come from:

- ✓ either the use of particular technologies (there is a required technological proficiency);
- ✓ or the particular habits resulting from the well-defined consumption habits of the market.

These variables can be used to explain some features which are not covered by other criteria, such as cultural, organizational or other nature differences, whichever it may be, features encountered especially within multinational companies.

Given this criterion, for example, it is not fair to include in the same SAS: (Deac, V., coord., 2014, p. 67)

- √ entities, which over time have had different strategies (eg. the Volvo brand bought the Geely Chinese group, or Rolls Royce and Bentley brands bought by Volkswagen, BMW respectively, in strategic segments in which their own brands are included);
- √ entities having a different history and culture by means of the leaders' personality;
- √ small firms within groups of branches, especially if they are multinationals.

e. Costs structure. One will consider cost-sharing issues of the company which is highlighting specific costs of each product line and the ones alocated to several lines, as well as the relationship between its costs and the alocated ones.

The more allocated (common) costs in the total costs of the respective product lines, the more justified the inclusion of these product lines in the same SAS.

A good costs management and understanding in strategic segmentation can provide a good strategic positioning of the organization regarding its competitors and the economic reality shows that many companies have disappeared due to wrong costs understanding and management. (Nagle,T.T.; Hogan, J.E., 2008, p. 241)

f. Customer type. This criterion requires such a grouping of product lines so that, within the same SAS, to include product lines addressed to customers who are sensitive to the same KSF and towards which the company can develop the same competitive advantage. These issues imply that the group of customers to whom products included in a SAS are addressed possesses the same demand intensity, the same consumption patterns and buying criteria etc.

The difficulty of using this criterion in approching strategic segmentation is related to understanding the content of the "customer" concept. Who is the customer? Many believe that the customer is the one buying the respective product, commonly called "direct customer". But this view is always the same with a strategic point of view? For example, if a supermarket buying an appliance in order to sell, the producer, rightly may perceive the supermarket as being an "intermediary", a distributor, the customer being the ultimate consumer (which can be tens or hundreds of thousands and very diverse). However, regarding strategic segmentation the respective supermarket considered as a distributor is taken into account. But if the supermarket buys the product for their own use it is indeed a customer. (Kotler, Ph., Armstrong, G., 2007)

However, this issue is not so simple, there are many exceptions which will have to be considered. For example, for a tire manufacturer "client" represents automobile manufacturers as well, incorporating these tires in their product, which in turn will be bought by individuals, as well as individuals who own cars that want to replace their tires. Yet, these two groups of customers cannot be included in the same strategic segment, the two types of customers having different value chains.

g. Skills and technology. This concerns primarily managerial skills. Managerial skills and technologies are closely related. Starting from product-technology consistency, it is easy to understand, for example, why it is not relevant to include both an electric control product line and a manual control one in the same SAS (eg. electrical and manual Gillette razors).

h. Geographical market**.** It is a fact which has already been proven that the geographical location of customers has an influence on their needs and distribution costs. Geographical criteria refer to the geographical location of customers (regions, countries), climate issues, stage of development, mastery of technology, etc.

Two excesses must be avoided when we consider the geographical dimension of a strategic segment:

- the first consists in underestimating the efforts required in order to include geographic markets with different competitive characteristics in the same SAS;

- secondly, that local thinking should not lead to strategic myopia that leads to omitting synergy effects and, consequently, to unoptimizing how to use resources for building and defending competitive advantages.

We mention that in determining SAS we should as well consider the existence of customers and competitors, and that the ultimate goal of the segmentation of the activity of a company and, finally, of the strategic segmentation is the exercise of a strategic competitive advantage over competitors so that a targeted particular client prefers the company's product. In a strategic segmentation approach, in sectors where there are many competitors' groups, each group occupying a distinct place in the market and having a specific image in the minds of buyers, a "mapping" of strategic groups is previously recommended (Porter, M., 1982, p.42). In the conception of M. Porter, "the strategic group consists of all competing companies in a market whose behaviour is alike."

In order to determine concretely the strategic activity segments one can resort to the matrix method reduction, consisting in the aggregate matrix representation of the products lines and of the segmentation criteria, thus yielding a first strategic segmentation and in order to check the relevance, the correctness of this segmentation, the key success factors of each determined strategic activity segment as well as the strategic competitors in each segment must be examined; finally, in terms of these two aspects the final strategic activity segments are obtained. We mention that there are several situations where a grouping of various strategic business segments within a single segment strategy is not possible because of different key success factors (although some criteria, for example, geographic market, technology, customer type, type of needs are the same) or because of various competitors.

Conclusions

In conclusion one can emphasize that these strategic segmentation criteria allow, in principle, to carry out a strategic segmentation, without omitting key-strategic issues. These criteria, in essence, can be divided into three types of variables, namely:

- √ external variables - customer, competition, distribution, geographical market;
- √ product related variables - technology, resources involved, skills;
- √ internal variables - costs structure, synergy.

However, in a practical approach to strategic segmentation, the final determination of the SAS, in addition to the correct segmentation criteria that have to be considered, we must not ignore the existence of competitors and customers, imposing a good knowledge of both the competitors (not the knowledge of competitors' names but the strengths and successful key factors of each competitor and customer), and the customers, meaning accurate knowledge of those elements that determine the value perceived by the customer, preference for the product of one company or another and, ultimately, their willingness to pay.

Correct identification of strategic business segments, which will be the "strategic portfolio of activities", provides the management of the company with a review of its based on the models of portfolio strategic analysis (eg. the B.C.G model, the ADL model etc.), models which enable the highlighting of future options as well. (Ducreux, J. M.; Abate, R.; Kachaner, N., 2009, p. 57)

The ultimate goal of this "segmentation" of the company's work in order to establish strategic activity segments is to exercise within each SAS a strategic competitive advantage over competitors for a particular targeted client to prefer the company's product.

Defining strategic activity segments improperly, as a first step in a process of developing the strategy of a company, can only lead to negative results, no matter how fair the other steps of the approach will be taken.

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