Getting Started With Value Segmentation to Identify Your Most Valuable Customers

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Free preview of Gartner research

Summary

Customer experience leaders must establish engaging relationships with customers while also contributing to business goals. CX leaders can leverage value segmentation to identify and focus on the customers most likely to maximize the business impact of CX and marketing initiatives.

Overview

Key Challenges

- Brands struggle to meet the rising experience expectations of their customers while simultaneously delivering revenue and profitability to the business.
- Brands that segment their customers along product or demographic lines fail to identify the most valuable customers and their needs, reducing potential impact to business key performance indicators (KPIs).
- Delivering the personalized experiences that customers expect on a finite budget is unmanageable if brands try to address all customers and all needs.

Recommendations

Customer experience leaders responsible for leading and managing CX initiatives should:

- Prioritize initiatives and spend allocation to the most important segments. Leverage Gartner's Value Framework to identify the prospects and customers most likely to positively affect the business.
- Socialize the efficacy of value segmentation to the organization by clearly defining and communicating what customer-centric value segmentation is (and isn't).
- Distinguish and document the unique characteristics of high value customers and prospects by mining existing customer data and documenting insights in actionable personas.

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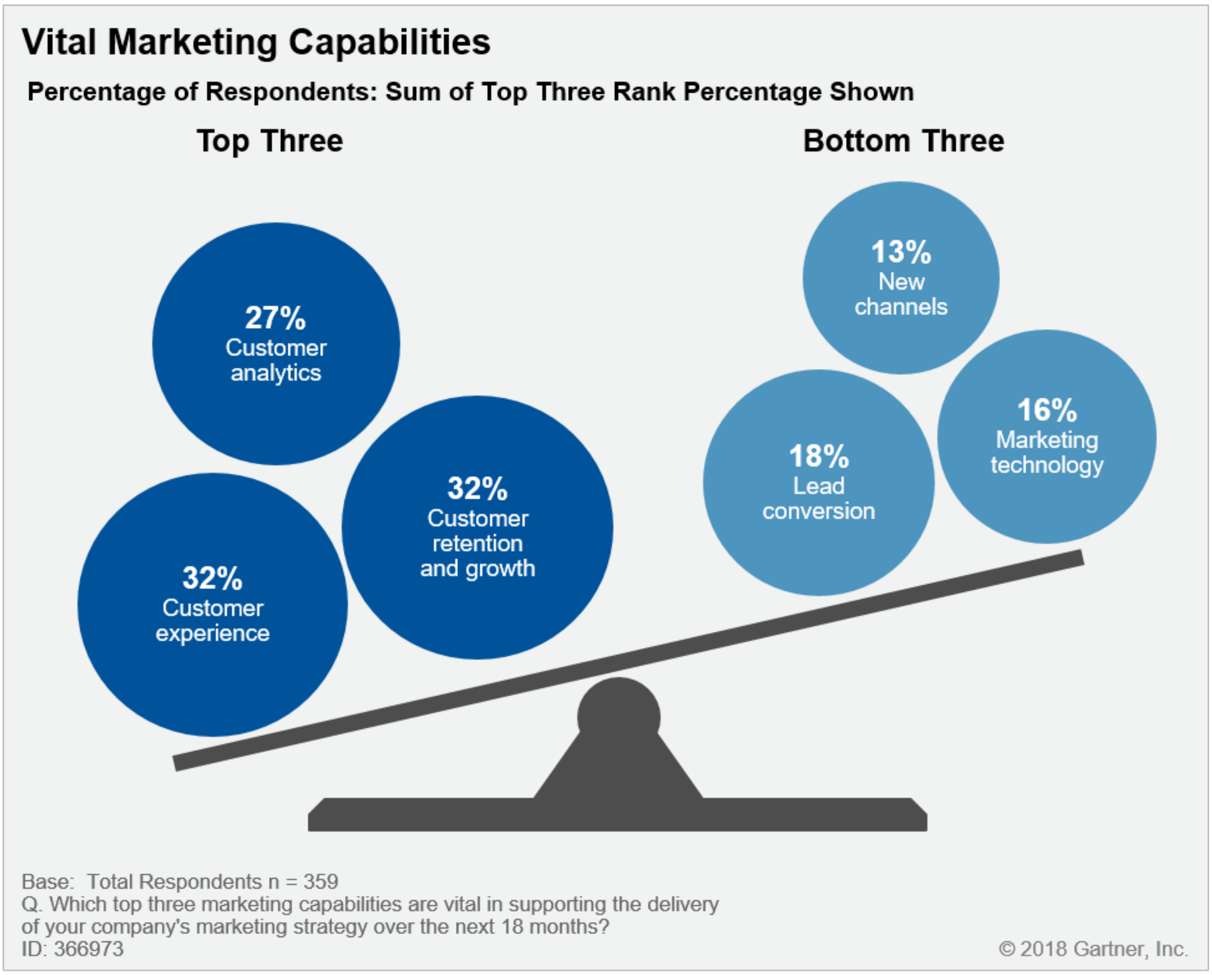
Introduction

The first step to delivering the experiences customers want and the results business leaders expect is to focus on the right customers. Marketing leaders recognize the importance of customer experience. As Figure 1 shows, customer experience, customer retention and growth, and customer analytics top the list of CMOs' vital marketing strategies (see "CMO Strategy Survey 2017: CMOs Go All in on Customer Marketing, but at What Price?"). The significance of CX as a competitive advantage is only expected to grow. Gartner's 2017 Customer Experience in Marketing Survey reveals that 67% of companies surveyed indicated they currently compete on the basis of CX. In two years, this expectation rises even further, with 81% of respondents anticipating their companies will compete mostly or completely on the basis of CX (see"Customer Experience in Marketing Survey 2017: Greater Expectations, Greater Challenges").

Figure 1. CMOs Identify Customer Experience as a Top Marketing Capability



SOURCE: GARTNER (JULY 2018)

Understanding, anticipating and satisfying customer needs is a strategic imperative. While a customer focus generally has strong support from the C-suite, overall marketing budgets declined last year. Gartner's CMO Spend Survey 2017-2018 found that after three years of consecutive growth, marketing budgets fell from a high of 12.1% of company revenue in 2016 to 11.7% in 2017. (See "CMO Spend Survey 2017-2018: Budgets Recede Amid Demand for Results.") As top brands raise the bar for the types of experiences that customers expect from all brands, marketing leaders are forced to do more with less to meet their customers' needs.

CX leaders feeling the pressure to compete on customer experience while delivering business results to the C-suite can leverage value segmentation to help identify and focus on their most valuable customers. "Value" in a customer-centric world extends beyond short-term profitability and a tally of product sales to more sophisticated customer relationships that consider profitability, loyalty and advocacy.

This note offers a framework for identifying and serving high-value customer segments. CX leaders can use it to justify customer-centric initiatives by showing how they contribute to near-term profitability and long-term growth.

Analysis

Apply Gartner's Value Framework to Your Segmentation Strategy

Segmentation allows marketers to focus on groups of customers who share attributes. As a marketing tool, it often is used to make product development, pricing, targeting, messaging and measurement decisions. Segmentation is a high-level categorical classification of *all* your customers, as opposed to personas that illuminate more personable details about a subset of your customers (or even a subset of a segment of your customers). Smart segmentation is an essential first step in deciding whom to target with customer experience initiatives (see "How to Build Segments and Personas for Digital Marketing").

Gartner's value segmentation model offers a simplified model for prioritizing customers according to lifetime value (see "How to Justify the Business Value of Your Customer Experience Investments"). Our value framework builds upon this model to offer a structure for identifying and understanding the different levels of value that customers can bring to a business. In a customer-centric world, the "value" of a customer to a brand includes advocacy — loyal customers who act as brand ambassadors — in addition to profitability.

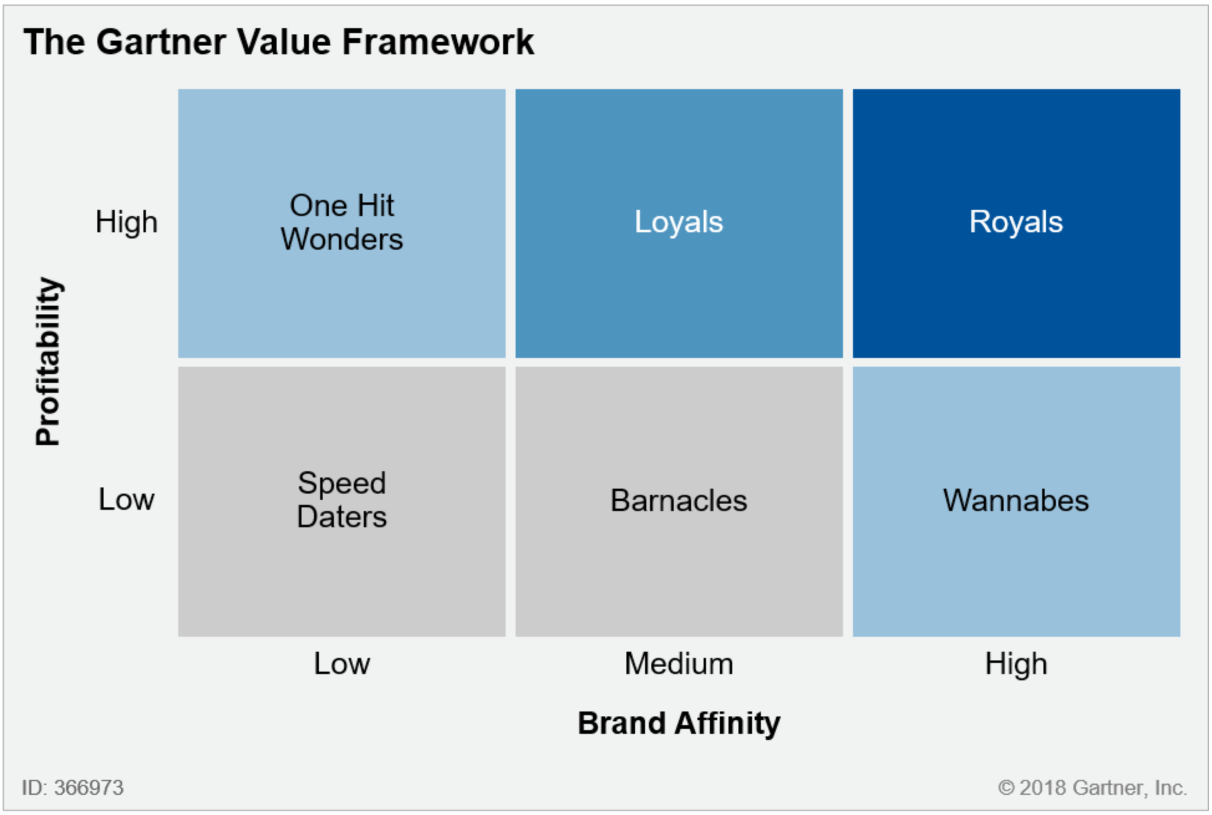
Customers who actively advocate for your brand are a valuable resource. Many marketers are aware of how user-generated content (UGC), such as ratings and reviews or unboxing videos, can have a significant impact not only on search visibility but also on sales conversions. Beyond awareness and conversion, however, social enables peer-to-peer conversations along the entire customer journey. Through social, prospective customers can reach out to existing customers for feedback not only on specific products but also on their postpurchase experience of a brand. Organizations can stimulate advocacy and word of mouth (WOM) by identifying customers with high brand affinity and actively nurturing and galvanizing them as brand advocates (see "Use Social Media to Improve Customer Experience Throughout the Entire Customer Journey").

The importance of nurturing existing customer relationships is reflected in current marketing strategies focused on retention, growth and social opportunities. In the 2017-2018 CMO Spend Survey, for example, the CMOs surveyed reported that nearly two-thirds of their marketing budget is allocated to customer retention and growth initiatives, outpacing budget allocation to customer acquisition by nearly 2-to-1 (see"Survey Analysis: Marketers Balance Their Investments to Acquire and Retain Customers"). In addition, Gartner's annual CMO spend survey indicates that an increasing percentage of total marketing budgets has been allocated to social in the past two years (see "CMO Spend Survey 2017-2018: Budgets Recede Amid Demand for Results").

Customers with a strong brand affinity are an asset to your brand. Once engaged and activated, they could be a source of WOM, awareness, consideration and referrals. Gartner's Value Framework incorporates affinity into its definition of value. As shown in Figure 2, it plots profitability against brand affinity:

- **Profitability:** Low-profitability customer segments include not only single purchasers but also multiple purchasers who buy at low margin and/or customers who require a lot of service. High-profitability customer segments include repeat purchasers who tend to buy at target margins and who tend to self-serve.
- **Brand Affinity:** Low-brand-affinity customer segments purchase for price and/or convenience and give little consideration to the brand. Medium-brand-affinity customers have a preference for the brand and tend to be repeat purchasers, but they can be swayed by targeted offers from competitors. High-brand-affinity customers purchase only your brand. They are great targets for brands to engage and activate as brand advocates.

Figure 2. Gartner's Value Framework



SOURCE: GARTNER (JULY 2018)

We group the six key customer segments into highest-value customers, valuable customers and low-value customers. This establishes a framework to strategically focus your efforts and spend.

Highest-Value Customers

You will want to focus the majority of your efforts on your highest-value customer segments — the "Royals" and the "Loyals," as summarized in Table 1.

Table 1. Highest-Value Customer Segments

Segment	Description	Strategy
Royals	These customers combine loyal, profitable buying habits with a deeper relationship with the brand. Royals love your brand. They are the ideal target for campaigns aimed at motivating brand advocacy.	Focus on understanding this segment's unique needs. Invest in designing unique, meaningful experiences that keep these customers engaged with your brand. Develop strategies and campaigns that turn this segment's high brand affinity into active WOM promotion and advocacy.
Loyals	These customers are long-term, profitable buyers with a good but not deep relationship with the	Invest in understanding this segment's unique needs and in understanding what might be needed to strengthen brand affinity and push individuals into the Royals. Develop strategies and campaigns that

Table 1. Highest-Value Customer Segments

Segment	Description	Strategy
	brand. Loyals like (as opposed to love) your brand.	deepen brand relationships and drive brand "love." Design experiences that demonstrate you understand this segment's needs and that ensure that doing business with you is as pleasurable as possible.

SOURCE: GARTNER (JULY 2018)

Valuable Customers

Valuable customer segments deliver value to the business either through infrequent purchases at profitable margins or through a deep relationship with the brand. You will want to accommodate these segments' unique needs when possible. Valuable customer segments include "One-Hit Wonders" and "Wannabes," as summarized in Table 2.

Table 2. Valuable Customer Segments

Segment	Description	Strategy
One-Hit Wonders	These short-term customers buy at profitable margins indicating that they see value in your offering, but they do not consistently make repeat purchases. One-Hit Wonders have not yet shown a preference for your brand.	Don't forget that your Loyals at one point were all One-Hit Wonders (even if briefly). Focus strategies on strengthening brand affinity to move individuals in this segment into Loyals. In addition to encouraging repeat purchases, seek out opportunities to engage this segment more deeply with the brand. Leverage insights from your existing Loyals to develop customer experiences that earn this segment's loyalty. Consider including this segment in campaigns and experiences aimed at Loyals, as what resonates with Loyals should resonate with One-Hit Wonders who have the propensity to become Loyals.
Wannabes	These customers have high brand affinity and love your brand, but may be less profitable for a variety of reasons (for example, single purchases, low-margin purchases, high cost to serve). Your brand	This segment's value is in their potential for advocacy. Focus on converting this segment's love for the brand into active WOM and advocacy. In addition, consider giving this segment the "Royal" treatment by including them in Royal campaigns and experiences that may

Table 2. Valuable Customer Segments

Segment	Description	Strategy
	resonates for them at a personal level and may be aspirational.	not be purchase focused (for example, include them in sneak previews of important announcements, solicit their feedback on product features and/or engage them in market research).

SOURCE: GARTNER (JULY 2018)

Low-Value Customers

Low-value customer segments do not contribute significantly to the business. While you want to deliver positive customer experiences to all your customers, do not invest in serving these segments' unique needs. Low-value customer segments are the "Speed Daters" and "Barnacles," as summarized in Table 3.

Table 3. Low-Value Customer Segments

Segment	Description	Strategy
Speed Daters	These low-profit customers most likely are bargain hunters. Price is everything and your brand means nothing to them.	Invest in understanding enough about this segment to be able to differentiate them from One-Hit Wonders. Do not invest in understanding or serving this segment's unique needs or in trying to convert them to loyal customers. Your budget is better spent on more valuable segments.
Barnacles	These customers are loyal in that they make repeat purchases and have a longer-term relationship with your brand, but they buy low-margin products and often use customer service excessively.	As a drain to profitability, either divest members of this segment or cut the cost of servicing them. Do not invest in trying to convert them to higher-profitability customers. Your budget is better spent on more valuable segments.

SOURCE: GARTNER (JULY 2018)

Socialize the Strategic Role of Customer-Centric Value Segmentation

Focusing your segmentation on high-value versus low-value customers makes targeting strategies not only easy to identify, but also easy to communicate and justify across the organization. In addition, value segmentation can help shift the focus of success metrics from specific campaign and operational metrics to more business-oriented growth metrics. This shift is achievable because efforts always focus on acquiring and retaining customers whose behavior contributes most effectively to greater revenue and profitability.

An important step when incorporating value segmentation into your marketing strategies is to bring all relevant stakeholders up to speed on what customer-centric value segmentation is and how it supports the business. One of the first distinctions you may need to make is that "value segmentation" means something different in a customer-centric model than it did in a product-centric model.

Customer-centric value segmentation focuses on customer attributes and on actively distinguishing between highest-value and low-value customers. Your stakeholders may have a legacy understanding of value segmentation as segmenting along the value that a customer finds in a product. Product-centric value segmentation focuses on product attributes.

The potential confusion of customer-centric value segmentation with product-centric definitions represents more than just a difference in semantics. By taking the focus off products and putting it on customers, customer-centric value segmentation extends the definition of "value" from short-term product purchases to longer-term profitable relationships with the brand.

Calculating the value of longer-term customer relationships is the basis behind metrics like lifetime value to customer acquisition cost ratios (LTV:CAC). In essence, long-lasting customer relationships can yield higher margin and lower costs, since the cost to acquire, retain and upsell that customer is reduced. CMOs estimate that for every $1 spent to retain an existing customer, it costs $3 to acquire a new customer. (This of course varies by industry. See "Survey Analysis: Marketers Balance Their Investments to Acquire and Retain Customers.") C-level stakeholders often are interested in LTV:CAC as a strategic metric because it aligns closely with profitability and long-term revenue growth.

Customer-centric value segmentation applies the principles of lifetime value to segmentation strategies. LTV most commonly is applied to a single customer to predict the net profit from all their future interactions with a company. Value segmentation focuses on lifetime value as a strategy for identifying the characteristics of highly profitable prospects and customers.

Once you have identified your highest-value customers, you can strategically focus your spend and fine-tune your efforts around:

1. Experiences that re-engage and retain your existing highest-value customers
2. Marketing campaigns targeted at prospects that look like your highest-value customers

For example, with Facebook's Lookalike Audiences you can upload a hashed customer list; Facebook uses the hashed data to match people on your list to people on Facebook. Or B2B marketers may run account-based lookalike programs using data providers like Dun & Bradstreet, Demandbase and others.

Focus on Your Highest-Value Customers

Gartner's Value Framework offers a structure for organizing, understanding and targeting your customers, but it is only the first step. Applying this framework to your own customers requires identifying the unique characteristics of individuals within your customer pool who are highly profitable and have strong brand affinity.

Your existing data may not allow you to clearly identify Royals — individuals who are both highly profitable and have a strong brand affinity. If not, focus on identifying the characteristics of your highly profitable customers alongside the characteristics of customers who love your brand. The attributes you identify then can be blended together in target personas that incorporate both.

Identify Characteristics of Your Most Profitable Customers

What a profitable customer "looks like" from a demographic, attitudinal or behavioral aspect will be unique to every business. To identify the profitable customers among your current customers, you will need to collect and analyze customer data from across the enterprise.
The lifetime value to customer acquisition cost ratio essentially measures the profitability of customers. The higher the ratio, the more profitable the customer. If you already calculate LTV:CAC for your existing database of customers, then you've already identified your most profitable customers.
If you don't calculate LTV:CAC, you can use the general approach behind it to differentiate your more profitable customers from your less profitable customers. In "CMO Insight: Connect LTV and Operational Metrics to Measure Digital Commerce Effectiveness," we break down in detail the operational metrics that contribute to LTV:CAC. These metrics fall into four major categories (see Table 4).

Table 4. LTV:CAC Data

Data	Measured By
Cost to acquire	The cost and effectiveness of marketing efforts to reach, engage and convert
Lifetime revenue	The average order value aligned with frequency and recency of purchases
Cost to support	Cost in terms of servicing the customer postsale, including the cost of returns
Retention	The propensity for the customer to churn, evidenced by satisfaction metrics

SOURCE: GARTNER (JULY 2018)

Basically, profitable customers are customers who cost less to acquire, buy at target margins, buy repeatedly and frequently, require little service and support, and are likely to stay engaged with the brand. Whether that is tied up in a single LTV score or you have to examine marketing, sales, service and churn data separately, the goal is to identify those customers who skew toward the positive side of profitability.
The Pareto Principle, also known as the "80/20 rule," states that roughly 80% of effects come from 20% of the causes. When applied to marketing, it suggests that 20% of customers may be responsible for 80% of sales, or on the flip side that 80% of complaints may come from 20% of customers. This of course is just an approximation that varies across businesses, but separating out the top 20% of customers in each category as your profitable customers may be a good target.
Examine all the data you have about them to pull out observations and classifications that characterize the top 20% of your profitable customers and that differentiate them from your bottom 80%. These may be demographic differences, behavioral differences or attitudinal differences, among others. For example, what products do your most profitable customers tend to buy? What campaigns have resonated with them? What channels (web, mobile, social, store) do they utilize? What services do they employ? What web content do they consume? What is their level of satisfaction? What are their technographics?
Data and insights based on your most profitable customers most likely will be of interest across the organization, from sales to the C-suite. Document your findings and clearly cite the data

sources for future reference. This data and information will be useful to you when designing campaigns and customer experiences designed to convert on purchase.

Identify Characteristics of Your High-Affinity Customers

Just as you identified the characteristics of highly profitable customers, you will want to do the same for your customers who demonstrate a high brand affinity. Focus on understanding your advocates specifically. In addition to understanding who they are and what differentiates them from other customers, concentrate on what motivates them to advocate for your brand.

Where identifying your profitable customers can focus on more quantitative research techniques, identifying your advocates and high-affinity customers may require a more qualitative voice of the customer (VoC) approach. Gartner categorizes VoC data into three types, as described in Table 5.

Table 5. Voice of the Customer Data

Data	Measured by
Direct feedback	Feedback that consumers intend to provide to the organization, typically in the form of a survey, complaint, market research or forum/panel.
Indirect feedback	Feedback derived from instances when the customer is speaking about an organization without specifically intending to furnish feedback to the organization. This includes collecting insight from review sites, social networks and customer care interactions via phone, email and chat sessions.
Inferred feedback	Operational and transactional data associated with a customer experience or "journey," such as a website's clickstream data, purchase history or contact center operational data.

SOURCE: GARTNER (JULY 2018)

Use VoC research to identify and understand two distinct types of customers:

1. Those customers for whom a strong brand affinity drives them to loyalty
2. Those customers for whom a strong brand affinity drives them to advocacy

While there certainly will be customers who are both loyal customers and advocates, loyal customers are not necessarily advocates, and advocates are not necessarily loyal customers in terms of purchase history. At this point, your goal is not to understand these groups as segments. Rather, understand what type of customer is likely to be brand loyal in terms of purchase and what type of customer is likely to turn their brand affinity into advocacy. Focus research not only on identifying these two types of customers, but also on understanding their distinguishing values, needs, motivations and goals.

As you did with your profitability research, document your findings and clearly cite the data sources for future reference. This data and information will be useful to you when designing campaigns and customer experiences designed to convert on "love." That is, when your goal is to transform customers from someone who simply uses your products or services into someone who actively loves your brand.

Develop Personas for Your High-Value Segments

Value segmentation is a strategic tool that helps you identify your most valuable customers. Personas are a tactical tool that combines strategic targets with research insights to help inform decisions, guide strategies and improve customer experience. Developing personas focused on your most valuable segments will help ensure your marketing efforts are focused on the needs of your most important customers as research has revealed them.

Personas allow you to pull together your profitability research and your affinity research. Persona content focuses on fictional representations of important subsets of your customer base who share similar attributes such as goals, needs and decision factors. In the process of identifying your most valuable customers and researching common characteristics, you should have uncovered a number of insights and data-backed observations about both your highly profitable customers and your high-affinity customers. Personas offer the opportunity to combine those insights into a single fictional profile.

While our value framework offers a segmentation structure for identifying your most valuable customers, the specific segments for which you choose to develop personas depends on your organization and on your specific goals. Some companies may wish to focus on the highest-value segments exclusively and develop a couple of fictional personas each for Loyals and Royals. Others may wish to cast a wider focus on both highest-value and valuable customers and produce a persona for the Loyals, Royals, One-Hit Wonders and Wannabes segments. Others still may choose some combination of the highest-value and valuable segments.

Whatever your approach, aim to keep your set to three to five personas. Personas are meant to strategically focus decisions on your most important customers and needs. More than five personas tends to dilute focus and complicate execution. For more on how to create actionable personas, see "How Marketing Leaders Make Personas Actionable."

Persona profiles of your most valuable customers provide insight into who they are, what they want, what they need and what motivates or interests them. Leverage this insight to design and implement highly targeted and personalized experiences that attract, retain and engage those prospects and existing customers who most closely match your ideal customer.

Acronym Key and Glossary Terms

LTV	Lifetime value: The total revenue or value of a customer relationship over a lifetime. This can be measured by customer, by segment or in aggregate for a cohort or group of customers. Sometimes referred to as customer lifetime value.
CAC	Customer acquisition cost: The total cost to achieve the first sale or transaction with a customer, including fully burdened marketing and sales costs, but not including any costs for remarketing or retention and loyalty programs. Sometimes referred to as cost of customer acquisition or cost per add.