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Segmentation Should be Your Pricing Backbone

Effective segmentation is the backbone of effective pricing. However, many managers find segmentation discussions tedious because, as the author explains, these discussions aren't being held in the context of pricing. Companies whose segmentation discussions don't address behavior, price structure, innovation and offer design, are missing out on a large untapped opportunity. Paul Hunt is the president of Pricing Solutions, a global pricing consultancy, and a frequent PPS contributor, instructor and presenter. He can be reached at phunt@pricingsolutions.com and his online pricing courses can be found at www.PricingSociety.com. His pricing column appears monthly in the Financial Post (www.financialpost.com).

Executives often start to feel their eyelids grow heavy at the term "market segmentation," or to reach for their BlackBerry to relieve the tedium. If this sounds like you or your company, you probably haven't been working on segmentation from a pricing perspective. **Effective segmentation is the backbone of effective pricing.**

Do any two people pay the same price for a seat on any given aircraft? You may argue that airline pricing is more confusing than effective, but I would say that is only because airlines have ruined a good thing. Leisure travelers are not willing to pay the same for a ticket as business people.

The pricing perspective is "How do I structure prices to capture the volume of the leisure travelers and the margin available from the business travelers?"

The answer: price fences, structural divides that keep segments apart and allow for differential pricing. Three effective fences that airlines use are class (business or tourist), booking lead time, and Saturday night stay-over. They are used to create price differentials even though everyone on the plane is going to the same place at the same time. This leads us to Lesson 1: **Segmentation should be linked to the price structure**.

For another example, consider a company who was manufacturing products sold to housing contractors. The company's customers were often on tight timelines and managing a labor pool consisting of many different trades. Through research, the company found that effective customer service (knowing detailed information about products and building codes, and order-delivery schedules) had tremendous value to customers. Furthermore the company found that the contractors believed some of the reps had valuable skills in these areas, and that presented with the right offer, contractors would be willing to pay to access this knowledge.

Based on this feedback, the company established two levels of customer service they could offer. They also used this feedback to determine how much to charge for the enhanced service and estimated what percentage of their customers would be willing to pay a certain premium. In this case, both customer and provider benefited, which leads to the second lesson: **Use segmentation to help guide you to innovate where the value is highest.**

Another example is a company who sold database information online. In their customer mix, they had large national customers who were willing to pay a high price and were very inexpensive to service per unit of data delivered. They had another segment of small business clients who were extremely price sensitive, took up a lot of time in the sales process, required heavy customization of the information to be sent, and then often didn't pay their bills on time.

Management's initial response was to "fire" the small customers, but the company needed them to complete the picture on the data-collection side of their business. Furthermore they represented significant volume.

For this segment, the company developed a bundled offer that raised the price but delivered much more value to this price-sensitive segment. Further, the offer required payment in advance. While customer count dropped slightly, volume increased dramatically and the company turned a loss to a profit on the customer profit contribution report. Lesson 3: **Creating a simple but comprehensive offer to motivate effective customer behavior is better than cutting price or firing your smaller customers.**

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To help you think about all the steps, consider this final example. A ski resort was recently faced with cutting the

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price of its annual pass substantially to be competitive with a neighboring resort, but they felt their best customers were very loyal and didn't need the price reduction. They worked on developing a premium season pass to appeal to this group.

One thing this elite group valued was time on the slopes without all the crowds, and before someone (paying a fraction of the price) ripped up all the fresh powder, so the resort created a premium pass that included "Fresh Tracks" access to the mountain one hour before it opened to the public. They then developed four or five other value-adds for this group, which enabled a price increase despite significant downward competitive pressure on prices.

At the other end of the customer base the resort offered the lower price pass, but limited access over the Christmas holidays and other busy holiday weekends. For this group they provided a competitive offering, but they also fenced them out on the busy days when the yield they delivered was below average.

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Untapped Opportunity

Too many businesses segment customers based on demographics such as age and income, or customer size and industry. **If your segmentation isn't leading you into a discussion about behavior, price structure, innovation and offer design, you probably have a large untapped opportunity.**

So next time segmentation is on the agenda, look up from your smartphone. Segmentation is hardly boring when you capitalize on untapped profits.