WHITEPAPER

Customer Segmentation

Focus Trade Funds on Your Best Customers

Contents

"All customers are not created equal; **potential profit** varies across customers. Segmentation helps companies allocate scarce resources — money and people — where they'll deliver the **highest payoff**."

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Why Customer Segmentation?

One foodservice industry best practice is for organizations to adopt a pricing and spending approach that is grounded in the discipline of customer segmentation.

Rather than rolling over historical spending rates year after year, segment your customers based on qualitative and quantitative measures to define pricing and spending levels and optimize the return on your investment.

It will take effort and resources to segment your customers and build the discipline into the organization.

Let's discuss the criteria to consider when segmenting your customer base. We'll show you an example of distributor segmentation followed by an example of standard offers based on customer segments.

A **best practice** to avoid pricing inequities and nonperforming dollars is to require justification and rationale for discounts, based upon volume, competition, costs or other strategic rationale.

IMAGINE...

...operating in a culture where customers' current and future value to the company drives the rates and tactics you offer them.

This would not only **optimize your investment** but **simplify the creation, evaluation and approval process** while providing a more customer-centric and proactive approach with customers.

Note: As an interim step while the longer-term process is underway, you can create a 'price/volume grid' to normalize spending tactics and rates into common options that sales should offer, resolving what each customer should receive based on their volume trend in core categories.

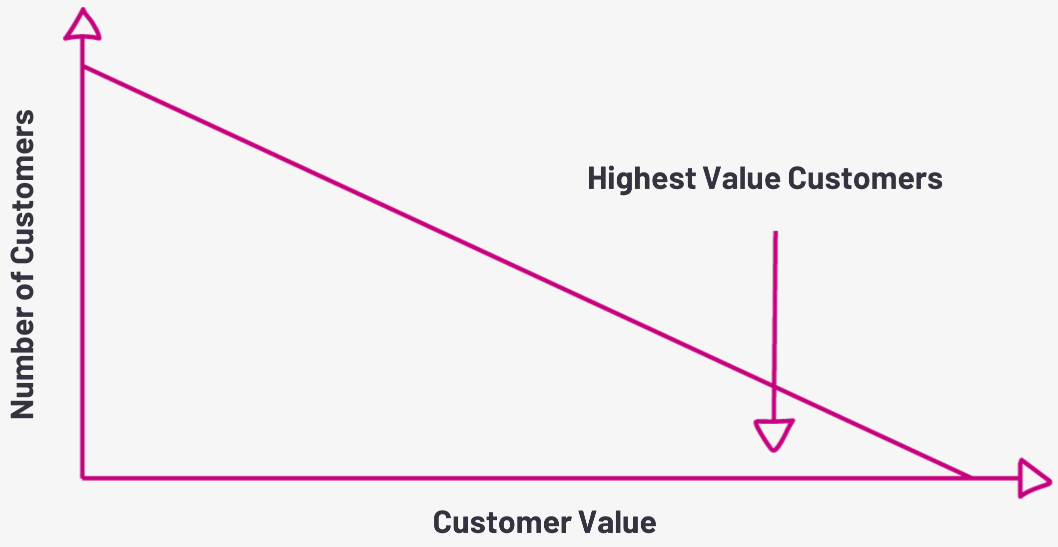
Defining Customer Segmentation

Customer segmentation is the process of:

- **Defining** categories of customers that serve to drive decision making
- **Framing** your options
- **Prioritizing** customers relative to one another

Each category should have a different value to the organization and determine how you should react to pricing, promotion and service-related opportunities.

Customer segmentation is important because distributor and operator customers are not homogenous and don't have all the same needs, expectations and priorities. There is a wide range of needs, preferences, resources and behaviors. To account for that variability with discipline, consider **classifying customers into segments based upon common variables.** These common characteristics support a standardized marketing mix, and more importantly, trade offer, for customers in each segment.



To optimize the return on your trade dollars, support your trade strategy.

BY UNDERSTANDING WHO, WHAT AND HOW

Who are we selling to?

Not all customers should be treated equally; rather, they are classified based on their present and future value. At the same time, each customer should not be treated uniquely, as the creation, evaluation and approval of a unique deal for each and every customer is time-consuming. **Identify standard offers with trade mechanics and rates established for each customer segment**.

What should we sell and how should we promote?

Sales and marketing should be consistent in how they prioritize brands and categories, operating off of the 'same page' relative to priorities, goals and discount mechanics (elimination of the 'a pound is a pound' and 'a lot of volume is always a good thing' mentality).

How do we execute?

The approval workflow to authorize promotional offers and the subsequent settlement of those events should be governed by both common sense and **control-based guidelines** (such as Sarbanes-Oxley) **to ensure process integrity**.

Identify the Segmentation Team

Customer segmentation can enable more efficient and effective use of company resources. Getting segmentation right, however, is challenging and requires strategy and planning, buy-in from senior management and focused implementation. Form a cross-functional team across key departments responsible for customer relationships and valuation. The members of the team will vary based on your organizational structure and responsibilities.

Customer segmentation can enable more efficient and effective use of company resources.

The Segmentation Team's Responsibilities

Now that you've identified your segmentation team, it's your responsibility to determine and reach consistent agreement on what you want to accomplish from customer segmentation and how you'll utilize this insight in your customer decisions.

Upon completion, segmentation should help your organization focus on the right set of customers.

It should help you build targeted packages of products, rates and tactics that are consistent, rational and structured for the spending capacity and equity of the brand(s).

Tasks for the Segmentation Team:

Identify Criteria to use in segmenting distributor and operator customers. Criteria might include volume, exclusivity, penetration and loyalty.

Collect Data and analyze it based on the attributes you selected.

Develop Profiles that clarify which customer segments represent the best fit with your criteria.

Map Customers to your defined segments.

Normalize Rates and tactics around standard spending guidelines by segment.

Execute! Assign segments for the majority of your customers. Train and educate the sales and marketing teams.

Step 1: Identify Segmentation Criteria for Distributor & Operator Customers

Due to foodservice distribution channels and industry dynamics, criteria to segment distributor customers are different than those used to segment operator customers.

To identify the criteria you'll use to segment your customer base, you'll want to:

- **Identify the core metrics** that drive your internal 'cost to serve' the customers. Typically, these are measures such as
  - Average order size
  - Breadth and depth of product line stocked
  - A/R days outstanding
  - Average deduction balance
- **Add quantifiable metrics that project future growth.**
- **Note qualitative metrics** (such as private label support levels and street vs. chain estimates). These are more difficult to consistently score but can be extremely valuable in stratifying the customer base.

Senior management should be involved in identifying the goals and expected outcome from a customer segmentation initiative.

Best Practices &
Key Criteria to Consider

- Customer Potential
- Usage Profile
- Loyalty
- Level of Partnership

Distributor Segmentation Criteria

Quantitative Metrics

- Corporate size
- Local size
- Estimated growth
- Line breadth – core categories in stock
- Line depth – core SKUs in stock
- Average order size
- Average accounts receivable days outstanding
- Ongoing deduction balance
- EDI/electronic data capability and cooperation

Qualitative Metrics

- Private label support
- Street vs. chain focus
- Durability/longevity

Challenges

- Dealing with poor local houses that belong to high scoring corporate entities
- Discipline to arrive at a classic bell-curve stratification

Operator Segmentation Criteria

Quantitative Metrics

- Overall segment size (units)
- Estimating margin $ per unit sold
- Current share of segment purchases
- Share opportunity
- Estimated growth
- Relevant points of contact

Qualitative Metrics

- Core menu presence
- Level of authorized options (hard vs. soft)
- Compliance with commitment
- Distribution control (compliance)
- Price sensitivity (food cost vs. consumer $)
- Consumer promotion strategy
- Branding/proprietary SKU predisposition
- Culinary requirements

Challenges

- Dealing with poor local houses that belong to high scoring corporate entities
- Discipline to arrive at a classic bell-curve stratification

Steps 2,3,4: Analyze, Develop & Map Customers

After you identify the segmentation criteria, you'll:

STEP 2: Analyze customer data based on these attributes

STEP 3: Develop distributor and operator customer segments

STEP 4: Map customers to defined segments

To complete these steps:

- Apply weights to each criterion based on importance.
- Identify classes or groupings into which you'll organize customers; what is 'good' in terms of these criteria; 'bad' and 'okay.' You want to **focus on a limited number of important variables to arrive at 3-8 segments**. Too many segments spreads your marketing budget too thin; too few doesn't allow for differentiation amongst customers.
- Analyze the data you have on customers and map them into segments.

Not every customer can be 'the best' – indexing scores will result in categories that are measurable relative to each other and provide a solid basis for application.

Foodservice manufacturers who successfully segment their customer base almost always do so with either a normal distribution curve or a quartile-based scheme. This prevents customers from bunching into groupings that are too large and homogenous to be meaningful.

Step 5: Normalize Rates & Tactics

Segmentation is the action, not the objective; the **objective is to rationalize customer offers based on value to the organization**. Step 5 calls for the identification of standard, pre-defined spending mechanics for each distributor and operator customer segment that support the range of tactical applications of funds currently in the market. Recommended rates/dollar amounts along with allowable ranges and spending caps should also be developed for each segment.

The **goal is to decrease the number of spending 'buckets'** to only those that have a correlation to the actual spending events themselves, normalize their definitions vis-à-vis tactics and enforce discipline for how to allocate money to each bucket so the dollars invested across the enterprise can be evaluated consistently.

For Example: Publish spending limits for each customer segment for rebates, trade show funds, flyers, DSR promotion, temporary price reductions, etc.

Step 5 Continued

When this is implemented, field sales should have the ability to offer the tactics and rates to customers as dictated by their customer segment and within budget constraints. Depending on your trade management system, this may reduce the manual work and time required to create, evaluate and approve deals, as well as facilitate customer responsiveness.

Manufacturers: Use this opportunity to be more proactive!

Rather than reacting to requests from each customer over the course of the year, best practices suggest that you adopt a mentality more closely resembling the retail trade. In this model, Distributor Trade funding would be released in two, six-month cycles and local brokers would receive funding amounts for **each key account in the following categories:**

- **TRADE SHOWS AND LOCAL EVENTS**
- **TEMPORARY PRICE REDUCTIONS**
- **SHELTER OR EARNED INCOME**
- **LOCAL MARKETING**
- **SALES INCENTIVES**

Step 6: Execute

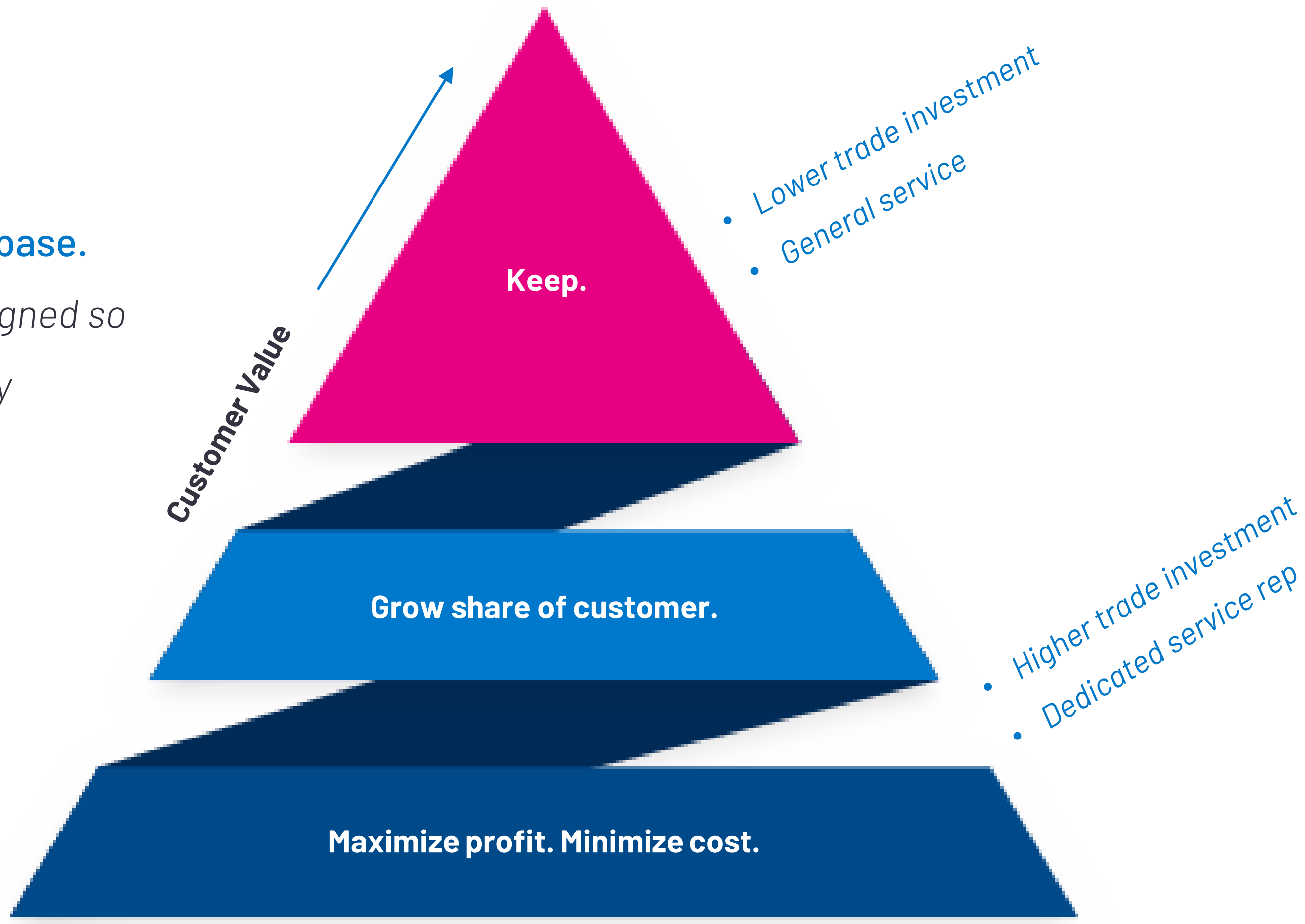
Given the time spent segmenting your customer base, you want to ensure that the team's hard work is utilized across the organization.

Indicate each customer's segment in your customer database.

Identify the segment to which each customer has been assigned so the segmentation scheme can be utilized in employees' daily functions and interactions with customers.

Roll out the program to marketing and sales.

Marketing and sales will be most affected by customer segmentations. Communicate the program to them, including goals of the project, the new customer segments and how it will affect their customer interactions.



Should you disclose to the customer what segment they've been assigned?

If they're one of your best customers, it could build loyalty and a sense of partnership. On the other hand, you may be giving them ammunition to leverage in negotiations. The communication can be valuable provided that your organization clearly articulates the specific areas where the customer is deficient or 'scores poorly' and what future results are required to qualify for an improvement in their segment assignment.

When executed properly, your customers will have a better understanding of what is most important to you relative to their future behavior and the rewards of moving in that direction.

You've classified customers into segments... Now, ensure the entire organization focuses the right resources on the right customers.

Assuming excellent execution, customer segmentation should **clarify a road map** for behavioral change to your customers that benefits your organization while offering them increasingly attractive rewards for doing so.

Example: Distributor Segmentation

In this example, weights have been assigned to each criterion, and 3 classes have been identified for each criterion into which customer data has been categorized.

		METRICS DEFINITION			HALLSMITH SYSCO	SPRINGFIELD FOODS	DONAHUE BROTHERS
Weight	Category	1	3	5	1030233	2438439	1238383
10	Corporate Size	<$500M	$500-$1B	> $1B	5	5	1
15	Local Size	<$80M	$80 to $120M	>$120M	5	3	3
12	Estimated Growth	<2%	2% - 5%	>5%	5	3	3
7	Line Breadth Index	<80	80 - 100	>120	5	3	3
7	Line Depth Index	<80	80 - 100	>120	5	3	1
7	Order Size	<25K lbs	25K - 35K	>35K	5	3	3
8	AR Outstanding	>30	20-29	<20	3	3	3
10	Deductive Balance	>$10K	$5K - $10K	<$5K	1	3	5
8	Private Label Support (SOIM)	>40%	25% - 40%	<25%	1	5	5
8	Street vs. Chain (Estimate)	>50%	35% - 50%	<35%	3	5	5
8	Durability	Actively pursuing exit OR >20% reduction since 2000	Positive earnings and stable size — discernable local advantages	Positive earnings and share growth	5	3	1
100				**TOTAL SCORE**	**396**	**352**	**282**
				QUARTILE	**96**	**72**	**53**
				CLASSIFICATION	**A**	**B**	**C**

Example: Standard Customer Offers Based on Customer Segments

In the model below, funds would be created and communicated to brokers and field sales for use against each of the 5 spending categories. Additionally, the classification would drive stratification of the size of the funds – essentially providing an underlying consistent logic to determine how much money each customer has access to for each category of spending.

	A	B	C
Customer Count	**20%**	**60%**	**20%**
Trade Shows	20%	15%	10%
Local Marketing			
TPR	50%	60%	70%
Sales Incentives			
Shelter	30%	25%	20%
SPENDING BOX	150%	75%	25%
RATE BASIS = $2	**$3.00/case**	**$1.50/case**	**$0.50/case**

Going Forward

Executive support and **change management are critical for success** of a customer segmentation initiative. Also, you'll want to review and update your customer segmentation periodically:

- Customers change
- The importance of your segmentation criteria change
- Even the criteria themselves may change over time

Finally, remember that segmentation is the action, not the objective; **the objective is to rationalize customer offers based on value to the organization** and so this must be an ongoing project to be successful.

We look forward to continuing the conversation.

Reach out to your sales representative or

hello@blacksmithapplications.com to get started.

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