



Focusing Trade Funds on Your “Best” Customers: Best Practices in Foodservice Customer Segmentation

Contents

Introduction	2
What is Customer Segmentation	2
Why Segment Your Customers	2
Identifying the Segmentation Team	3
The Segmentation Team’s Responsibilities	4
Step 1: Identify Segmentation Criteria for Distributor and Operator Customers	4
Distributor Segmentation	5
Operator Segmentation	5
Steps 2-4: Analyze and Map Customers	6
Step 5: Normalize Rates and Tactics	6
Step 6: Execution	7
An Example of Distributor Segmentation	8
An Example of Standard Customer Offers Based on Customer Segments	9
Going Forward	9

“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.”



Introduction

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, segmenting customers based on qualitative and quantitative measures should define pricing and spending levels in order to optimize the return on your investment. In this white paper, we'll discuss criteria to consider when segmenting your customer base and provide an example of distributor segmentation with an example for standard distributor offers.

A best practice to avoid pricing inequities and non-performing 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.

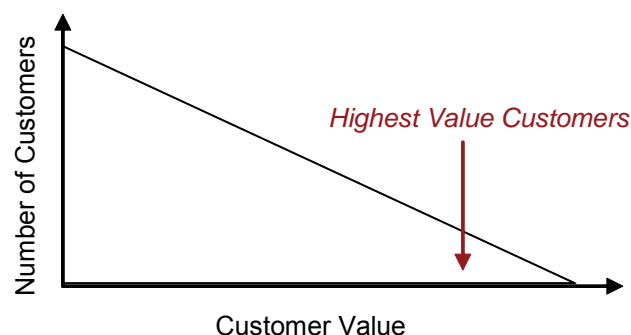
It will take effort and resources to segment your customers and build the discipline into the organization. As an interim step while the longer-term process is underway, you can create a 'price/volume grid' to normalize spending tactics and rates into common options that Sales should offer, resolving what each customer should receive based on their volume trend in core categories.

What is Customer Segmentation

Customer segmentation is the process of defining categories of customers that serve to drive decision-making, frame your options and prioritize them 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.

Why Segment Your Customers

Customer segmentation is important because distributor and operator customers are not homogenous and do not 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.



In order to optimize the return on your trade dollars, your organization needs to understand and effectively support your trade strategy. This requires an understanding of:

- 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 insure process integrity.

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.

Identifying the Segmentation Team

You'll want to 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. Typical members include sales, marketing, finance, and sales operations or planning, along with a dedicated analyst who can pull data necessary to analyze customers, either from internal or external sources. You may want an IT person dedicated to the team who will extract data from internal databases to support the segmentation effort.

Customer segmentation can enable more efficient and effective use of company resources. Getting segmentation right, however, is challenging and requires strategy and planning, senior management buy-in, and focused implementation.

“Customer segmentation can enable more efficient and effective use of company resources. Getting segmentation right, however, is challenging and requires strategy and planning, senior management buy-in, and focused implementation.”



The Segmentation Team's Responsibilities

Senior management should be involved in identifying the goals and expected outcome from a customer segmentation initiative. As you undertake this project, team members and senior management must determine and reach consistent agreement on what you want to accomplish from segmenting your customers and how you'll utilize this insight in your customer decisions.

The team should be tasked with executing the following:

1. Identify criteria [such as volume, exclusivity, penetration and loyalty] to use in segmenting distributor customers and operator customers
2. Collect and analyze data on these attributes
3. Develop profiles of distributor and operator customer segments that clarify which segments represent the best fit with your criteria
4. Map customers to segments
5. Define standard offers and spending guidelines by segment
6. Execute! This includes assigning segments for the majority of your customers, training and educating the Sales and Marketing teams and helping them understand how the discipline will effect their customer interactions.

Upon completion of the project, segmentation should help your organization focus the right level of effort 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].

Step 1: Identify Segmentation Criteria for Distributor and 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 and average deduction balance.
- Additional quantifiable metrics to include would be size, both as a customer as well as within the local market, and projected future growth.
- Qualitative metrics such as private label support levels and street vs. chain estimates 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.”



Following are some best practice criteria we recommend. Customer potential, loyalty, usage profile and level of partnership with your company are key criteria to consider.

Distributor Segmentation

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

Challenges

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

Qualitative Metrics

Private label support
Street vs. chain focus
Durability/longevity

Operator Segmentation

Quantitative Metrics

Overall segment size [units]
Estimated margin \$ per unit sold
Current share of segment purchases
Share opportunity
Estimated growth
Relevant points of contact

Challenges

Sales and broker deployment and discipline against the resulting road map
Marketing collaboration

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



Steps 2-4: Analyze and Map Customers

After identifying the criteria you'll use to segment your customer base, you want to focus on steps 2-4:

2. Analyze customer data on these attributes
3. Develop distributor and operator customer segments
4. Map customers to segments

To complete these steps, you will:

- Apply weights to each criteria based on how important each is
- 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 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.

Foodservice manufacturers who have successfully segmented 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. 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.

Step 5: Normalize Rates and Tactics

Segmentation is the action, not the objective; the objective is to rationalize customer offers based on value to the organization. Therefore, 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.

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 the trade management system utilized, this may reduce the manual work and time required to create, evaluate and approve deals, as well as facilitate customer responsiveness.

Manufacturers may also 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 manufacturers 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



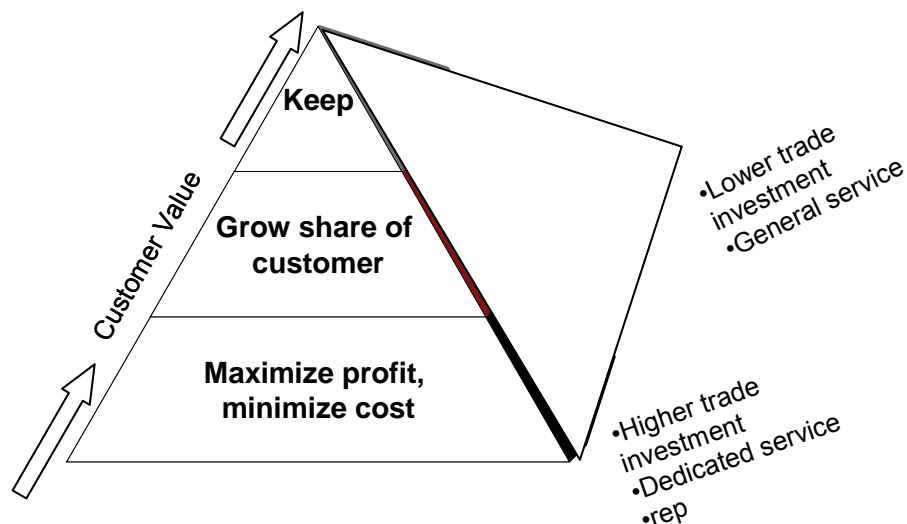
Step 6: Execution

The final step is Execution. 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 – first, you want to 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 segmentation. Communicate the program to them, including goals of the project, the new customer segments and how it will affect their customer interactions. Training, change management activities and ongoing management will be key to ensure ongoing alignment with the strategy. Consider other ways to ensure active implementation of the strategy such as compensation.

At the start of your segmentation project, you should identify how segmentation will affect customer interactions and what functional groups segmentation will affect, and how. Clearly, it should be used in Marketing and Sales efforts, but will it impact Customer Service? Will you provide a dedicated customer service account manager, different support number or service options to your best customers? Will you provide additional resources to help increase penetration of 'Segment B' customers? Now that you've classified customers into segments, you want to ensure the entire organization focuses the right resources on the right customers.

Consideration should be given to whether or not you should disclose to the customer what segment they have been assigned. If they're one of your best customers, it may help build loyalty and a sense of partnership. On the other hand, you may be giving them more ammunition to leverage in negotiations. The communication of the segmentation 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. 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.



An Example of Distributor Segmentation

Following is an example of customer segmentation utilizing the criteria identified above. In this example, weights have been assigned to each criterion, and three classes have been identified for each criterion into which customer data has been categorized.

WEIGHT	CATEGORY	METRICS DEFINITION			HALLSMITH SYSCO	SPRINGFIELD FOODS	DONAHUE BROTHERS	
		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 - 120	>120	5	3	3	
7	Line depth index	<80	80 - 120	>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	Deduction 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



An Example of 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 five 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	50%	60%	70%
TPR			
Sales Incentives			
Shelter	30%	25%	20%
Spending Index	150%	75%	25%
Rate Basis = \$2	\$3.00 per case	\$1.50 per case	\$.50 per 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.



866-572-9299 (toll free)

webcontact@bigredflame.com

www.BlacksmithApps.com

60 Island Street
Lawrence, MA 01840



Visibility. Accountability. Profitability.

© 2003 Blacksmith Applications

BESTCUST0809