You've Got Permission, Now Be Relevant:
How to Use Segmentation, Targeting, and Personalization to Deliver Relevant Email

Part One:
Why Segmentation, Targeting, and Personalization Will Determine Your Future Success . . . And What to Do About It

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Introduction

Segmentation. Targeting. Personalization. All are common buzz words used among marketers today. However, they are not new concepts. Academics have been writing about market segmentation for over 50 years. Don Peppers and Martha Rogers Ph.D raised the stakes in 1993 when they published *The One to One Future*, and Seth Godin fueled the fire for permission-based email marketers in 1999 with *Permission Marketing.*

Incredible potential can be unleashed by acting upon segmentation, targeting, and personalization strategies. Consider Amazon.com who, amidst considerable skepticism about their business model, built arguably the online world's most valuable asset—the Amazon.com CRM database. This database enables the use of segmentation, targeting and personalization techniques that deliver value to the customer while maintaining a very high level of trust. In short, these methodologies enable Amazon.com to deliver targeted and personalized messages to a very appreciative audience, which then translates into profit.

In the early days of email marketing, generating high response rates and a good return on investment (ROI) proved relatively easy—definitely easier than other direct marketing channels such as direct mail. The low costs associated with email made the potential for ROI high. A generic email message sent to thousands of subscribers resulted in response rates that no other medium had ever achieved. Yet these days, it takes more than batch and blast messages to sustain high response and ROI.

As email marketing progresses, delivery of relevant and timely communications is becoming ever more crucial to a successful program. This whitepaper focuses on *Segmentation, Targeting, and Personalization* to provide an in-depth look at the strategies and tactics that marketers must adopt in order to deliver customer-centric messages.

Part One of this whitepaper will delve into the background and strategies that one must understand prior to acting. Part Two is a how-to guide for the implementation and steps needed to create personalized, segmented, and targeted campaigns.

Background and Strategies

Are Segmentation, Targeting, and Personalization Right for You?

If you're wondering whether these tactics are right for your organization, you should first consider the current state of your relationship with your customers and prospects. Ask yourself: Do I already have a close and personal relationship with them? Or am I trying to ***build*** a personal relationship with them? It's important to know because:

The need to deliver highly personalized and targeted messages *increases* the farther away you are from your prospective customer.

If you ***do not*** have a real and personal relationship with the customer—if you ***do not*** recognize your customers when you see them on the street—then embracing the strategies and tactics outlined in this whitepaper is especially important to the success of your long-term email initiatives. If you already have a close relationship, these strategies may not be necessary elements to your marketing plan.

Why Must You Act Now?

Your future email success depends on your ability to be relevant ***now.*** Today. This Moment.

Email is crossing a critical threshold in its evolution as a marketing channel—one that other mediums such as television, radio, print, and direct mail have already crossed. While the strengths and weaknesses of those “mature” channels are understood, the full potential of email is just now becoming clear. The key, regardless of the type of email communication (e.g., newsletter, promotion, customer service, etc.), is ***relevance.*** As email matures, the game will look increasingly similar to other channels: “noise” levels and competition will increase. Those who connect with their customers through relevant, timely messages will come out on top in email.

Defining Segmentation, Personalization, and Targeting

Depending on the context, the terms segmentation, targeting and personalization can mean different things. Before getting too far into the strategies associated with them, it’s important to define them in the context of email marketing:

> **Segmentation** is the process of dividing customers, or potential customers, into distinct groups (“segments”) that have similar needs that can be satisfied by delivering similar value propositions.
>
> **Targeting** is the process of delivering relevant messages to segments in a manner that best matches your organizations value propositions to the unique needs of a segment.
>
> **Personalization** is the process of tailoring specific elements of targeted messages to individuals within a segment.

Why Should You Avoid Batch and Blast?

Although Batch and Blast campaigns can appear profitable on the surface, the long-term drawbacks will soon outweigh any short term benefits.

Remember: the customer base is NOT a homogeneous group, and there will NOT always be more of them willing to opt-in to your emails.

Example: Let’s consider a fictitious company *Northern Trail Outfitters.* Northern Trail Outfitters is a specialty retailer focused on outdoor enthusiasts. Unique customer segments may include kayakers, hikers and mountain bikers. Northern Trial Outfitters could target these segments by creating unique content on kayaking, hiking and mountain biking. Messages could then be personalized by providing information on local store information or local events related to each outdoor activity.

Economics of Email: Different than Other Marketing Channels

The high cost associated with most marketing channels creates a natural barrier against poor marketing practices. Unless the program yields a decent conversion rate, it is impossible to generate a profit. This is not the case with email. The low cost of email makes it possible to turn a profit even if conversion rates are terrible. Consider the following example:

> *Spammer sends 100,000 unsolicited emails which costs approximately $200 (and a couple hours work) to send. 10 people convert for an average of $100 a piece.*

The spammer just made $800 profit on a 0.01% conversion rate! This equates to a 400% Return on Investment. These are the types of numbers that make SPAM work from an economic standpoint.

Alternatively, consider direct mail. The cost of sending 100,000 pieces of direct mail will cost at least $20,000. In order to break even at the same average sales price, the “spammer” would need to generate a 0.20% conversion rate. In other words, the campaign would need to generate twenty times the number of conversions just to break even—one hundred times the conversion rate—in order to maintain the same profit margin.

MarketingSherpa warns against “letting the low cost of email seduce you into being lazy.” (*Email Marketing Metrics Guide 2005,* MarketingSherpa). High returns with minimal investment have lulled many marketers into simple batch and blast email marketing tactics that still work, even though industry response rates have dropped significantly in the past three years. However, the long-term drawbacks will soon outweigh any short term benefits.

Customer-Centric Email vs. Batch and Blast Email

Any marketer who is unsure as to whether or not a customer-centric email strategy is worthwhile should consider the following:

- **The customer base is NOT a homogeneous group.** Batch and blast tactics work on the premise that all customers are equally likely to respond to the same message. Evidence shows that your customers are NOT all the same. They have different needs. They have different attitudes toward your products and services. It’s no wonder that organizations that segment their customer bases yield higher email campaign response rates—regardless of the attributes used for segmentation. (Source: JupiterResearch Executive Summary, November 2004)
- **There will NOT always be more customers.** Batch and blast email tactics can work so long as the customer base is constantly replenished. However, studies show that the number of prospects available to any organization is limited. Only 36% of US online households report that they are likely to sign up for emails in 2005. (Source: *The End of Email List Growth,* Forrester Research, November 2004) The market penetration IS nearing the saturation point. Thus, driving revenue from email is no longer a matter of simply finding more willing subscribers. It is now a battle for email market share.
- **The well WILL run dry.** Batch and blast tactics assumes that marketers can endlessly tap into their customer database to drive revenue. Yet sending irrelevant emails or sending email too frequently causes subscribers to respond in one of two ways: opt-out or ignore you. Once this decision is made, it is very difficult to rebuild trust and win them back.

Instead of looking at the customer base as an asset that can be endlessly exploited, you should think of it as an appreciating asset—like a bank or IRA account. As long as you invest properly and draw against the account in moderation, the long-term value of the asset is maintained and you will be able to draw against it for a long time. However, if you liquidate the asset today, know that there will be no money left tomorrow.

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>
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Ideally, individuals should be treated individually—this is the objective of customer-centric marketing strategies. However, tailoring highly personalized messages to each individual in the customer base can be an overwhelming aspiration. Practically, marketers need to deliver the most relevant messages as possible—with profitability in mind.

Market Segmentation

Although everyone is a *potential* customer, only a select group will become *actual* customers. An even smaller group will become *loyal* customers. As opposed to the market at large, the market segment is a group of similar people who likely have a need that your organization can satisfy.

The 80/20 rule states that 80% of your revenue will come from 20% of your customer base. Time and again this rule has proved itself in business. The thing that differentiates "great" marketers from "good" marketers is that they learn to use multiple layers of segmentation to change the dynamics of the 80/20 rule. They move beyond this first level of segmentation and refine segments so that each group generates more revenue, higher profit margin, higher adoption, etc.

Consider the following three levels of segmentation of a customer base:

Level 1: Everything appears to be going well. Profits are being made throughout.

Level 2: A group of customers who are not profitable for the organization emerges.

Level 3: Grouping becomes more complex. These are now segments around which strategies should be developed. By dividing the customer base into fifths (or "quintiles"), and the top quintile in half (each representing a "decile"), the customers are in groups that may be manipulated in order to improve the overall profitability of the company.

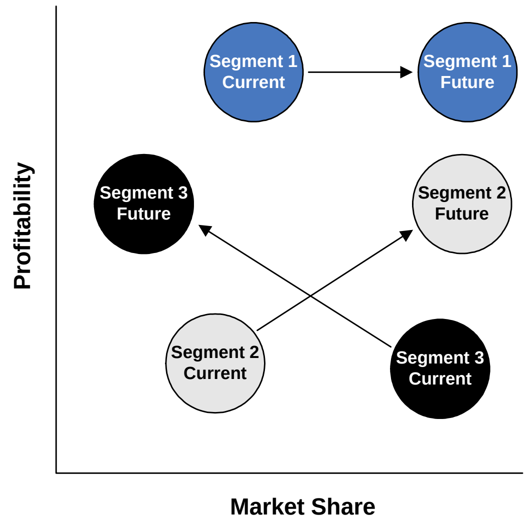
Looking at these segments, there are three groups each requiring vastly different strategies:

> **Strategy one: Profitable customers need to be thanked.** The top quintile is very profitable. We could try to upsell them. However, by continually pushing them to buy more, we may actually risk offending this segment and loosing their business. This group may not require incentives to continue their relationship with you, but simple thanks and recognition may go a long way.
>
> **Strategy two: Losers may require "discipline."** We know that the bottom quintile costs the organization money – the organization is paying to have them as a customer. We could fire the bottom quantile and immediately save the company money, or develop a strategy that will bring them up to a profitable level. Either way, their profit-taking behavior can not continue long term.
>
> **Strategy three: Move middle segments up the ladder.** Moving segments up the ladder – from marginally profitable to highly profitable -- requires understanding the motivations and expectations of each segment and acting accordingly. This group will likely require

an additional level of segmentation to identify segments with similar value expectations. These expectations can then be addressed in ways that convince customers to invest more in their relationship with the organization.

The Customer Base as an Asset: Building Customer Value

Target Segment Pathing



Customer-centric strategies consider the segmentation of customers based on their current value to the organization, but it doesn't stop there. The future, or potential, value of the customer must be considered. Your current customer mix may not be as profitable as you would like. Your best customers today may not be your best customers tomorrow. Each segment should be addressed in a way that maximizes the long-term revenue and profit potential of the entire customer base.

A long-term segmentation strategy addresses the unique needs of each segment in order to increase the value of customers to the organization. This is accomplished by increasing your organization's value to customers. It is reciprocal—it is a relationship where each party gets something of value at the end of the day and feels good about it.

Example: Amazon.com

Amazon.com rules on online retail world. Why? Because they offer a great customer experience and they have developed the trust of their customer base. This was not always the case. During the burst of the dot-com bubble Amazon.com was the black-sheep of the stock market. They were the proverbial "over-speculated" internet company and hit a low of $5.51/share in October 2001. At a time when there was enormous pressure to get out of the red and it would have been possible to make a killing selling valuable data on their customers—they didn't. In reading Amazon's annual and quarterly reports, it is clear that their entire business strategy is founded on customer experience and customer trust. They understood something that everyone else overlooked; the customer base is an enormous *asset*.

(Sources: *Hitwise U.S. Data Week Ending 09/25/04*, Hitwise and *Amazon Reigns; Wal-Mart Asleep at the Web*, Vividence Corporation, October 2004).

Remember, it is not realistic to expect that the value of *every* customer can be increased. The objective is to increase the value of the overall customer base.

In order to increase overall value of the customer base, one must make decisions about which segments can become more valuable, which segments need to be grown, and which segments should be avoided. Customer-centric strategies are long-term. If the goal is to maximize current value with a cavalier approach to future or potential value, then customer-centric strategies are a waste of time. However, good marketers will recognize that the customer base is

The Customer Base Value

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not a resource to be exhausted, but an asset to be valued and maintained wisely.

The example below demonstrates the strategies and decisions that can be made for different customer segments:

Example: Northern Trail Outfitters Segments & Strategies

Mountain Bikers: Very profitable for Northern Trail outfitters, but they have a modest share of the mountain biking market.

Strategy: The logical strategy is to try and gain market share in this area. However, this comes with the inherent risk that gaining market share may impact the profitability of this segment.

Hikers: This segment is not very profitable and they have a limited share of the hiking market.

Strategy: There is a difficult decision to make regarding this segment. Should Northern Trails attempt to grow this segment while increasing profitability? Leave the segment alone and just take the modest profit? Or abandon the segment and step away from this marginally profitable line of business? Increasing profitability and market share simultaneously will be difficult and requires significant investment.

Kayakers: Not very profitable group, but Northern Trail Outfitters has a very large share of the market.

Strategy: Again, there is a decision to make. Either attempt to increase profitability of the entire segment and maintain high market share or select a sub-segment of this group that and attempt to make them very profitable. It will be easier for Northern Trail Outfitters to increase profit margins if they are willing to loose some market share.

Each segment represents a separate set of potential strategies. The value of the customer base can be improved by successfully executing any of them. The next step is to decide which strategies are most likely to be successful and begin tactical planning.

Leveraging Customer Data:

You should not only use the information you have accumulated on customers and prospects to react to events, but to also predict events and then act accordingly.

Credit card companies are renowned for this strategy. Go to a college campus during the first few weeks of class in the spring. There will be a small army of tables offering free t-shirts and other gifts to any student willing to sign up for a new credit card. Is this because students are highly profitable customers for credit card companies? No, these companies are targeting a segment with high *future* value.

First of all, college students are likely to live longer. Second, if you are going to target people that have a long life expectancy, it makes sense to target people who have high earning potential. They are going to be able to spend more money, in the long-term, on your credit card. Where these companies often fall short is that they neglect the retention aspect of the relationship. They often fail to change the terms of the agreement to offer more favorable rates and the benefits that come along with actually having money. Again, both acquisition and retention are critical to customer-centric marketing strategy. You should not only use the information you have accumulated on customers and prospects to react to events, but to also predict events and then act accordingly.

An appropriate message might say, “Hi Joe! Congratulations, you’ve graduated! Now, let us offer you this new credit card that allows you to earn frequent flier miles!” This limits the competition’s ability to draw this loyal customer away.

Segmentation and Targeting Methodologies

Industry experts have proposed several different methodologies for segmentation and targeting. This section outlines several methodologies and looks at the common elements that can be used when applied to email marketing:

Peppers & Rogers Group: IDIC Methodology

This methodology consists of four steps:

- **Identify** customers individually and addressably
- **Differentiate** customers or customer groups based on their needs and value
- **Interact** with customers in a way that benefits them and the company, continually gathering relevant information about them
- **Customize** the relationship over time by changing aspects of the company's behavior toward individual customers based on understanding of the customer’s needs and value

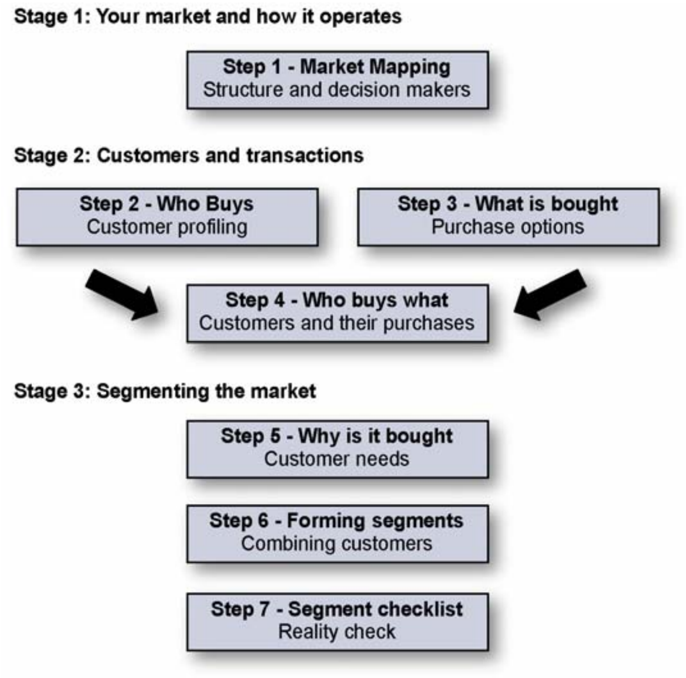
DeBonis, Balinski & Allen: 5 Step Process

As outlined in their book *Value-Based Marketing for Bottom-Line Success*. The five steps are:

- **Discover – Understand the Customer** includes understanding the market, understanding customer expectations, discovering customer segments, assessing competitive position, selecting target segments
- **Commit – Commit to the Customer** includes defining segment strategies, developing offerings, creating an organization and processes that support the strategy, defining key performance indicators or metrics
- **Create – Create Customer Value** includes creating a culture committed to customer value, process planning, investing in required infrastructure, implementation
- **Assess – Obtain Customer Feedback** includes tracking won and lost business, seeking customer feedback, resolving customer complaints, assessing performance against customer expectations, performing analysis that can be used to improve processes
- **Improve – Measure and Improve Value** includes identifying gaps, challenging corporate understanding of customers, redefining customer value commitments, improving customer value, anticipate change

McDonald and Dunbar: 3 Stage, 7 Step Process

They propose a three stage, seven step process for developing segments in their book *Market Segmentation: How to do it and How to Profit from it*. See next page for a diagram.



Each of these customer-centric models yields different insights into the process of segmenting and targeting customers and prospects. While there are definitely different points of emphasis the proponents all these models agree on several critical components:

- The first and hardest step is committing to a long-term approach that is right for your company and your customers
- Developing a strategy based on market conditions and actual customer information
- Implementation is crucial. Poor implementation will derail any strategy no matter how good it is.
- Ongoing monitoring and adjustments need to be made to the strategy based on feedback from customers

Email is Unique

Email marketing has a unique set of challenges when implementing customer-centric strategies. First and foremost, our target audience is limited to individuals who sign up for permission-based email. Second, SPAM has created a lot of skepticism toward email marketing. Approximately 67% of email is now being flagged as SPAM (Source: Symantec BrightMail, January 2005) and customers often perceive legitimate permission-based email as SPAM (Source: Jupiter Research, *Overcoming the Spam Effect*, January 2004). Legitimate email marketers must acknowledge that customers may well perceive permission-based email messages as SPAM—especially if outbound messages are irrelevant or sent too often.

The permission-based email list has already gone through one very significant level of segmentation. Everyone (assuming proper practices have been adopted) on the list has expressed an interest in the organizations value proposition at one point or another. This is a huge benefit for the email marketer. Yet oftentimes, very little is known about the subscriber at the beginning of this relationship—especially if all that has been collected is an email address. It is not enough to know that they are interested; marketers should learn *why* they are interested or *what* they perceive as the value proposition.

Given skepticism about email that is the byproduct of SPAM, we know that in order to earn trust, we must do it intentionally and systematically. In contrast to many direct mail campaigns, these customers have already selected themselves as a target audience. Thus, in theory, email response rates should consistently approach 100% (at least in terms of email opens!). In comparison to other channels, industry average response rates may be good, but consider the following:

- Subscribers to permission-based email start out interested in hearing your value proposition
- Email is cheap and makes it relatively simple to deliver highly targeted and relevant messages
- If customer expectations can be met consistently, response rates should approach 100%

Increase Response Rates:

ExactTarget's top performing clients consistently send large volumes of email and see average open rates in excess of 70%. Click-through rates exceed 25%!

How can your organization do the same? Learn how in Part Two.

In light of these facts, 40% industry average open rates and 6-8% industry average click-through rates are not impressive. In fact, they suggest that email marketers fail to succeed when dealt a winning hand. Why?

ExactTarget's top performing clients who consistently send large volumes of email see average open rates in excess of 70% and click-through rates in excess of 25%. How have they been able to beat the industry averages by such a large margin? Go back to the first step, "Discover", outlined by *DeBonis, Balinski & Allen*, these highly successful clients understand their customers and are successful at meeting customer expectations.

How can your organization reach these kinds of response rates?

Part Two of this series focuses on 1) the attributes that can be collected and imputed based on information that has been gathered on the customer, and 2) how email can be leveraged to act on those attributes.

