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PRODUCT DIFFERENTIATION AND MARKET SEGMENTATION AS ALTERNATIVE MARKETING STRATEGIES

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DURING the decade of the 1930's, the work of Robinson and Chamberlin resulted in a revitalization of economic theory. While classical and neoclassical theory provided a useful framework for economic analysis, the theories of perfect competition and pure monopoly had become inadequate as explanations of the contemporary business scene. The theory of perfect competition assumes homogeneity among the components of both the demand and supply sides of the market, but diversity or heterogeneity had come to be the rule rather than the exception. This analysis reviews major marketing strategy alternatives that are available to planners and merchandisers of products in an environment characterized by imperfect competition.

Diversity in Supply

That there is a lack of homogeneity or close similarity among the items offered to the market by individual manufacturers of various products is obvious in any variety store, department store, or shopping center. In many cases the impact of this diversity is amplified by advertising and promotional activities. Today's advertising and promotion tends to emphasize appeals to *selective* rather than *primary* buying motives and to point out the distinctive or differentiating features of the advertiser's product or service offer.

The presence of differences in the sales offers made by competing suppliers produces a diversity in supply that is inconsistent with the assumptions of earlier theory. The reasons for the presence of diversity in specific markets are many and include the following:

1. Variations in the production equipment and methods or processes used by different manufacturers of products designed for the same or similar uses.
2. Specialized or superior resources enjoyed by favorably situated manufacfacturers.
3. Unequal progress among competitors in design, development, and improvement of products.
4. The inability of manufacturers in some industries to eliminate product variations even through the application of quality control techniques.
5. Variations in producers' estimates of the nature of market demand with reference to such matters as price sensitivity, color, material, or package size.

Because of these and other factors, both planned and uncontrollable differences exist in the products of an industry. As a result, sellers make different appeals in support of their marketing efforts.

Diversity or Variations in Consumer Demand

Under present-day conditions of imperfect competition, marketing managers are generally responsible for selecting the over-all marketing strategy or combination of strategies best suited to a firm's requirements at any particular point in time. The strategy selected may consist of a program designed to bring about the *convergence* of individual market demands for a variety of products upon a single or limited offering to the market. This is often accomplished by the achievement of product differentiation through advertising and promotion. In this way, variations in the demands of individual consumers are minimized or brought into line by means of effective use of appealing product claims designed to make a satisfactory volume of demand *converge* upon the product or product line being promoted. This strategy was once believed to be essential as the marketing counterpart to standardization and mass production in manufacturing because of the rigidities imposed by production cost considerations.

In some cases, however, the marketer may determine that it is better to accept *divergent* demand as a market characteristic and to adjust product lines and marketing strategy accordingly. This implies ability to merchandise to a heterogeneous market by emphasizing the precision with which a firm's products can satisfy the requirements of one or more distinguishable market segments. The strategy of product differentiation here gives way to marketing programs based upon measurement and definition of market differences.

Lack of homogeneity on the demand side may be based upon different customs, desire for variety, or desire for exclusiveness or may arise from basic differences in user needs. Some divergence in demand is the result of shopping errors in the market. Not all consumers have the desire or the ability to shop in a sufficiently efficient or rational manner as to bring about selection of the most needed or most wanted goods or services.

Diversity on the demand side of the market is nothing new to sales management. It has always been accepted as a fact to be dealt with in industrial markets where production to order rather than for the market is common. Here, however, the loss of precision in the satisfying of customer requirements that would be necessitated by attempts to bring about convergence of demand is often impractical and, in some cases, impossible. However, even in industrial marketing, the strategy of product differentiation should be considered in cases where products are applicable to several industries and may have horizontal markets of substantial size.

Long-Term Implications

While contemporary economic theory deals with the nature of product differentiation and its effects upon the operation of the total economy, the alternative strategies of product differentiation and market segmentation have received less attention. Empirical analysis of contemporary marketing activity supports the hypothesis that, while product differentiation and market segmentation are closely related (perhaps even inseparable) concepts, attempts to distinguish between these approaches may be productive of clarity in theory as well as greater precision in the planning of marketing operations. Not only do strategies of differentiation and segmentation call for differing systems of action at any point in time, but the dynamics of markets and marketing underscore the importance of varying degrees of diversity *through time* and suggest that the rational selection of marketing strategies is a requirement for the achievement of maximum functional effectiveness in the economy as a whole.

If a rational selection of strategies is to be made, an integrated approach to the minimizing of total costs must take precedence over separate approaches to minimization of production costs on the one hand and marketing costs on the other. Strategy determination must be regarded as an over-all management decision which will influence and require facilitating policies affecting both production and marketing activities.

Differences Between Strategies of Differentiation and Segmentation

Product differentiation and market segmentation are both consistent with the framework of imperfect competition.[1] In its simplest terms, *product differentiation* is concerned with the bending of demand to the will of supply. It is an attempt to shift or to change the slope of the demand curve for the market offering of an individual supplier. This strategy may also be employed by a group of suppliers such as a farm cooperative, the members of which have agreed to act together. It results from the desire to establish a kind of equilibrium in the market by bringing about adjustment of market demand to supply conditions favorable to the seller.

Segmentation is based upon developments on the demand side of the market and represents a rational and more precise adjustment of product and marketing effort to consumer or user requirements. In the language of the economist, segmentation is *disaggregative* in its effects and tends to bring about recognition of several demand schedules where only one was recognized before.

Attention has been drawn to this area of analysis by the increasing number of cases in which business problems have become soluble by doing something about marketing programs and product policies that overgeneralize both markets and marketing effort. These are situations where intensive promotion designed to differentiate the company's products was not accomplishing its objective—cases where failure to recognize the reality of market segments was resulting in loss of market position.

While successful product differentiation will result in giving the marketer a horizontal share of a broad and generalized market, equally successful application of the strategy of market segmentation tends to produce depth of market position in the segments that are effectively defined and penetrated. The differentiator seeks to secure a layer of the market cake, whereas one who employs market segmentation strives to secure one or more wedge-shaped pieces.

Many examples of market segmentation can be cited; the cigarette and automobile industries are well-known illustrations. Similar developments exist in greater or lesser degree in almost all product areas. Recent introduction of a refrigerator with no storage compartment for frozen foods was in response to the distinguishable preferences of the segment of the refrigerator market made up of home freezer owners whose frozen food storage needs had already been met.

Strategies of segmentation and differentiation may be employed simultaneously, but more commonly they are applied in sequence in response to changing market conditions. In one sense, segmentation is a momentary or short-term phenomenon in that effective use of this strategy may lead to more formal recognition of the reality of market segments through redefinition of the segments as individual markets. Redefinition may result in a swing back to differentiation.

[1] Imperfect competition assumes lack of uniformity in the size and influence of the firms or individuals that comprise the demand or supply sides of a market.

The literature of both economics and marketing abounds in formal definitions of product differentiation. *From a strategy viewpoint,* product differentiation is securing a measure of control over the demand for a product by advertising or promoting differences between a product and the products of competing sellers. It is basically the result of sellers' desires to establish firm market positions and/or to insulate their businesses against price competition. Differentiation tends to be characterized by heavy use of advertising and promotion and to result in prices that are somewhat above the equilibrium levels associated with perfectly competitive market conditions. It may be classified as a *promotional* strategy or approach to marketing.

Market segmentation, on the other hand, consists of viewing a heterogeneous market (one characterized by divergent demand) as a number of smaller homogeneous markets in response to differing product preferences among important market segments. It is attributable to the desires of consumers or users for more precise satisfaction of their varying wants. Like differentiation, segmentation often involves substantial use of advertising and promotion. This is to inform market segments of the availability of goods or services produced for or presented as meeting their needs with precision. Under these circumstances, prices tend to be somewhat closer to perfectly competitive equilibrium. Market segmentation is essentially a *merchandising* strategy, merchandising being used here in its technical sense as representing the adjustment of market offerings to consumer or user requirements.

The Emergence of the Segmentation Strategy

To a certain extent, market segmentation may be regarded as a force in the market that will not be denied. It may result from trial and error in the sense that generalized programs of product differentiation may turn out to be effective in some segments of the market and ineffective in others. Recognition of, and intelligent response to, such a situation necessarily involves a shift in emphasis. On the other hand, it may develop that products involved in marketing programs designed for particular market segments may achieve a broader acceptance than originally planned, thus revealing a basis for convergence of demand and a more generalized marketing approach. The challenge to planning arises from the importance of determining, preferably in advance, the level or degree of segmentation that can be exploited with profit.

There appear to be many reasons why formal recognition of market segmentation as a strategy is beginning to emerge. One of the most important of these is decrease in the size of the minimum efficient producing or manufacturing unit required in some product areas. American industry has also established the technical base for product diversity by gaining release from some of the rigidities imposed by earlier approaches to mass production. Hence, there is less need today for generalization of markets in response to the necessity for long production runs of identical items.

Present emphasis upon the minimizing of marketing costs through self-service and similar developments tends to impose a requirement for better adjustment of products to consumer demand. The retailing structure, in its efforts to achieve improved efficiency, is providing less and less sales push at point of sale. This increases the premium placed by retailers upon products that are presold by their producers and are readily recognized by consumers as meeting their requirements as measured by satisfactory rates of stock turnover.

It has been suggested that the present level of discretionary buying power is productive of sharper shopping comparisons, particularly for items that are above the need level. General prosperity also creates increased willingness "to pay a little more" to get "just what I wanted."

Attention to market segmentation has also been enhanced by the recent ascendancy of product competition to a position of great economic importance. An expanded array of goods and services is competing for the consumer's dollar. More specifically, advancing technology is creating competition between new and traditional materials with reference to metals, construction materials, textile products, and in many other areas. While such competition is confusing and difficult to analyze in its early stages, it tends to achieve a kind of balance as various competing materials find their markets of maximum potential as a result of recognition of differences in the requirements of market segments.

Many companies are reaching the stage in their development where attention to market segmentation may be regarded as a condition or cost of growth. Their *core* markets have already been developed on a generalized basis to the point where additional advertising and selling expenditures are yielding diminishing returns. Attention to smaller or *fringe* market segments, which may have small potentials individually but are of crucial importance in the aggregate, may be indicated.

Finally, some business firms are beginning to regard an increasing share of their total costs of operation as being fixed in character. The higher costs of maintaining market position in the channels of distribution illustrate this change. Total reliance upon a strategy of product differentiation under such circumstances is undesirable, since market share available as a result of such a promotion-oriented approach tends to be variable over time. Much may hinge, for example, upon week-to-week audience ratings of the television shows of competitors who seek to outdifferentiate each other. Exploitation of market segments, which provides for greater maximization of consumer or user satisfactions, tends to build a more secure market position and to lead to greater over-all stability. While traditionally, high fixed costs (regarded primarily from the production viewpoint) have created pressures for expanded sale of standardized items through differentiation, the possible shifting of certain marketing costs into the fixed area of the total cost structure tends to minimize this pressure.

Conclusion

Success in planning marketing activities requires precise utilization of both product differentiation and market segmentation as components of marketing strategy. It is fortunate that available techniques of marketing research make unplanned market exploration largely unnecessary. It is the obligation of those responsible for sales and marketing administration to keep the strategy mix in adjustment with market structure at any point in time and to produce in marketing strategy at least as much dynamism as is present in the market. The ability of business to plan in this way is dependent upon the maintenance of a flow of market information that can be provided by marketing research as well as the full utilization of available techniques of cost accounting and cost analysis.

Cost information is critical because the upper limit to which market segmentation can be carried is largely defined by production cost considerations. There is a limit to which diversity in market offerings can be carried without driving production costs beyond practical limits. Similarly, the employment of product differentiation as a strategy tends to be restricted by the achievement of levels of marketing cost that are untenable. These cost factors tend to define the limits of the zone within which the employment of marketing strategies or a strategy mix dictated by the nature of the market is permissive.

It should be emphasized that while we have here been concerned with the differences between product differentiation and market segmentation as marketing strategies, they are closely related concepts in the setting of an imperfectly competitive market. The differences have been highlighted in the interest of enhancing clarity in theory and precision in practice. The emergence of market segmentation as a strategy once again provides evidence of the consumer's pre-eminence in the contemporary American economy and the richness of the rewards that can result from the application of science to marketing problems.