

Market Segmentation: A Tool for Improving Customer Satisfaction and Retention in Insurance Service Delivery

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Abstract

This paper looks at the use of market segmentation as a tool for improving customer satisfaction in insurance service delivery. Insurance companies are always seeking alternative ways to improve the level of satisfaction among their customers; market segmentation may be a useful tool. The paper argues that in spite of the egalitarian approach that underpins the marketing of insurance, market segmentation may be used to better serve the needs of their customers. In utilizing market segmentation, the insurance companies must pay particular attention to barriers that may negatively impact the effectiveness of the market segmentation exercise. Consequently, the need to pay particular attention to issues relating to barriers to implementing market segmentation is highlighted. This paper also attempts to address management's concerns about the practicality and usefulness of segmentation.

Keywords: insurance, market segmentation, customer satisfaction, customer retention.

INTRODUCTION

Many institutions including insurance companies spend a considerable portion of their time, energy and resources chasing new business. Although it is important to replace lost business, grow the business and expand into new markets, one of the primary goals should be to keep existing customers and enhance customer relationships. Conventional wisdom suggests that it costs at least five times more to get a new customer than to keep an existing one (Weinstein, 2002). According to Weinstein, in many markets, share of customer, which is a customer retention measure, has supplanted market share, which is a customer attraction measure, as the relevant business performance objective. Consequently, a good understanding of customers' purchasing patterns helps companies keep customers and gain a greater share of their business. This applies also to insurance companies.

Customer satisfaction, customer loyalty and customer retention are important intermediate goals for financial service providers on their way to superior economic success in the liberalized markets. As market growth slows or as the markets become more competitive, companies will more likely attempt to maintain their market share by focusing on retaining existing customers, rather than attempting to attract new customers. Customer retention has been advocated. To improve customer retention, companies initiate a variety of activities, including programs on customer satisfaction (Rust & Zahorik, 1993), complaint management (Fornell & Wernerfelt, 2003), and loyalty (Reichheld, 2000). Speed and Smith (1992) advocate the use of segmentation as a way to improve customer satisfaction, customer loyalty and customer retention.

Increasingly more firms have been focusing on the advantages of placing more emphasis on defensive strategies (designed to retain existing customers) than on offensive strategies (designed to attract new customers). The existing customers are already familiar with the company's products and services. A portion of this group is likely to be positively predisposed towards the products and services of the company. Hence the focus is therefore on individual customers instead of traditional market share. Most academic research into segmentation in the financial services industry has focused on alternative approaches and base variables while little attention has been paid to implementation issues, despite management's concerns about the practicality and usefulness of segmentation.

Despite the advantages which segmentation can bring, financial institutions in general and insurance companies in particular, have been slower to capitalize on its potential than other industries (McKechnie and Harrison, 1995). However as the regulatory situation has changed, competitive pressures have increased and profits have been squeezed, so that many institutions are now looking for ways to direct their resources at the most lucrative customer groups. According to Doyle (1995), the combination of economic conditions and regulatory forces, together with an increase in competitive activity, has resulted in an upsurge in interest in market segmentation.

Academic research in the financial service sector, as in other industries, has sought to identify appropriate segmentation, suggest that a priori segmentation, which charges the researcher with determining the size and characteristics of segments, as outlined by

Green (2001), is the most widely used approach. The use of demographic variables such as age and social class, are especially popular. Post hoc segmentation is less widely used. This entails the grouping of respondents according to their responses to particular variables. Multi-variate techniques may be applied to post hoc research, such as cluster analysis, factor analysis or multidimensional scaling.

LITERATURE REVIEW

Market segmentation involves the grouping of customers with similar needs and buying behavior into segments, each of which can be reached by a distinct marketing programme. The concept attempts to reconcile differing customer needs with limited company resources, and allows product and marketing offerings to be adjusted to suit different customer groups (Wind, 1978). The theoretical grounding for market segmentation comes from economic pricing theory, which indicates that profits can be maximized when prices that discriminates segments are set (Frank et, al., 1972).

According to Kotler (1994), companies from all industries are increasingly embracing target marketing. This has followed a natural progression “Mass Marketing”, where one product is produced and sold to all buyers and “Product-differentiated marketing” where more than one product, with different features, styles and characteristics are produced for offer to a variety of buyers. The essence of target marketing is that customers are heterogeneous in their buying requirements and behavior, and therefore these companies will be in a stronger position to serve certain customer segments.

The result is that financial institutions should identify those areas of the market which are more attractive to them and which they are most able to serve effectively. This will require a careful analysis of the structure of the industry, and the relationship between customer satisfaction and return on investment, as well as an assessment of the organisation’s capabilities and resources (Doyle, 1995).

Keaveney (1995) classified those customers’ reasons for switching service providers into eight general categories.

- Pricing
- Inconvenience
- Core service failure
- Failed service encounters
- Response to failed service
- Competition
- Ethical problems and
- Involuntary switching

The segmentation exercise is intended to minimize incidences of service failures that promote switching. The cost of switching by customers is usually significant to institutions

Aim of Market Segmentation

The underlying aim of market segmentation is to group customers with similar needs and buying behavior into segments thereby facilitating each segment being targeted by a distinct product and marketing offerings to be developed to suit the requirements of different customer segments (Wind, 1978).

Market segmentation is widely regarded as a panacea for a variety of marketing ailments. However research in the financial services market highlight a number of significant barriers to the implementation of segmentation programmes. The barrier may include the lack of availability of appropriate customer data and an organisational philosophy that is mindful of the differences between customers. While the marketing literature acknowledges that these difficulties exist, there has been little formal analysis to capture the characteristics of these barriers. Typically in the financial services sector, the industry competitiveness has become very high. This change has resulted in increased interest in market segmentation from financial service providers, including insurance companies, who believe that it may help in pursuing new opportunities and ultimately lead to more satisfied customers (Speed & Smith, 1992). Certain characteristics of the insurance sector indicate that it is a suitable area for market segmentation. Most notable among these is a diverse customer base with a wide range of needs and buying behavior.

Weinstein (2002) advocates that service providers attempt to know who the better customers are through the use of demographic, geographic, psychographic and benefit research. In doing so a profile of the “typical user” is determined. Such information then becomes very useful in the subsequent marketing effort. To retain customers and to gain a larger share of their business, service providers need to develop better understanding of the customers’ purchasing pattern. Increasing a company’s share of customers’ business can ultimately have a dramatic impact on market share and profitability. In evaluating customers’ usage and loyalty pattern, recency, frequency and monetary value (RFM) analysis can be a useful tool. Recency refers to the last service encounter, frequency looks at how often the customer contact/company experiences occur, and monetary value assesses the amount that is spent, invested or committed by the customers for the firm’s product and service,

Bases of Market Segmentation

In seeking to develop the use of market segmentation, insurance companies need to properly assess the bases of segmentation before commencing on such an exercise. This would involve settling on the best mix between the following:

- Demographic
- Lifestyle
- Psychographic
- Attitudinal

Segmentation bases such as age or lifestyle may be found to be “too crude” as they give insufficient insight into customer requirements and behaviour, such as which distribution channels they prefer to use. The insurance companies may therefore have to attempt more sophisticated forms of segmentation, using attitudinal or psychographic data gathered from a small sample of customers. The small sample size tends to make weaknesses in the data even more apparent, with the result that it may not be possible to allocate customers to segments with a high degree of confidence.

Potential Benefits of Market Segmentation

The marketing literatures (Kotler, 1994; Wind, 1978) suggest that segmentation leads to more satisfied customers, because it offers practitioners a number of clear benefits including:

- Improved understanding of customer needs
- More appropriate resource allocation.
- Clearer identification of market opportunities and
- Better turned and positioned marketing programmes

According to the marketing literature, with segmentation helping organisations to identify market opportunities and improving the allocation of resources, this should assist in the development of a sustainable competitive position and ultimately leads to more satisfied customers (Wind, 1978).

Zeroing in on profitability by customers allows insurance companies to identify the mix of products and services that reaps the most revenue and to promote that mix to less active customers to have a product profile that is similar to that of the profitable customers. The insurance companies then can build a predictive behavioural model that identifies customers that are most likely to purchase highly profitable product or use existing accounts in a way that produce more revenue and also points out which product customers in certain segments are most likely to purchase next. The collective power of the profitability analysis and the market segmentation is key to anticipating customers’ insurance product needs and serving them better.

Implementing Market segmentation

In developing and introducing segmentation strategies to their customer base for the first time, financial service providers may find that they encounter barriers in a number of areas. These barriers can be seen to affect the segmentation, targeting and positioning stages in the segmentation process.

- **Segmentation barrier** the customer data necessary for segmentation may not be available. Additionally, once the gaps in the organisation’s database have been identified, it may be difficult to find viable processes to address those gaps. Where data is available, in some cases, it is more “accounting” rather than “marketing” driven. This data shortage may force insurance companies to continue with relatively simple forms of segmentation which, while they are practical, are likely to overlook important issues which could enhance the insurance companies understanding of the customer needs and profitability. The need for a comprehensive customer database in the financial service sector is key to segmentation and to the understanding of customers in general.
- **Targeting barrier** the insurance companies may find that it is not appropriately positioned to make best use of segmentation. Effective segmentation requires clear strategic objectives, and a willingness to embrace customer selectivity—all with strong senior management support
- **Positioning barrier** there may not be a good fit between the chosen segmentation approach and the distribution channel that the insurance companies use to reach its customers.
- **General barrier** the organisational context may not provide an environment in which segmentation could be made. This should be combined with supporting organisational structures, and with coherent and integrated management of the range of distribution channels with which the customer may come into contact.

Key considerations in implementing segmentation programmes

- **Segmentation approach** whether the insurance company has sought to apply a consistent approach to segmentation across products, bringing age, lifestyle and income variables together into a “base” segmentation model for all financial products.
- **Collecting and managing data** analysis of customer data to gain improved understanding of customer profitability and the customer behaviour that influences it. The challenges will be to link the customer behaviour that determines profitability and other customer characteristics that can be identified prior to account opening. Thought will have to be given to the process of integrating all databases into a single source of customer data, so that the best use can be made of the increasing quantities of

behavioural data such as the transactional data from the current account and debit/credit card systems. The use of new analytic advisors, trained to carry out financial review with key customers.

- **Using data in the marketing effort** use of database information in recruiting approaches such as direct mail and press advertising. Some customers are unwilling to buy complex financial services such as pension without personal attention from a qualified member of staff. Insurance companies will have to make investments in analysis and modeling to ensure that direct marketing campaigns for services such as internet buying are carefully targeted. The analytical models can be used to identify potential customers who are likely to be responsive to direct mail and who are good risk.
- **Conduciveness of the business environment** Despite much discussion on segmentation and its use in assisting a customer focus in strategy and planning, a product-focused organisational structure persists at many companies, with marketing staff organized into product-based teams. Where appropriate, a culture change has to take place to ensure that product focused teams adopt a customer-focused perspective. This change should be driven by the companies' clear brand statement, marketing strategy and positioning. Additional investments should also be made to provide for better integration of systems across distribution channels, so that full details of customers' transaction with the companies are made instantly available.

Targeting Barrier

Insurance companies need to avoid the "mass marketing trap" "and to exploit the benefits of a carefully considered targeting strategy. Financial services providers, particularly insurance companies, face great difficulties in trying to leave behind the mass marketing or product-differentiated marketing approach. This may in part be due to the "egalitarian" view that is held by some bankers and insurers which argues that all customers are equally important and should receive similar quality service (White, 1992). Financial institutions that take this view to its conclusion are in danger of rejecting segmentation by arguing that all customers can be satisfied with one set of products and one set of marketing programmes. If segmentation is accepted at all within the egalitarian framework, the objective for segmentation is likely to be seen as helping the financial institution increase its focus on the customers and enhance its understanding of customers' needs. No customers will be excluded with this approach and strategies of

customer selectivity would be rejected in favour of servicing all customers.

Although the egalitarian approach may appear to offer certain benefits, there are dangers in taking this view point too far. The differing product and services requirements of customers may not be recognized. Management may fail to acknowledge the value of identifying and appropriately resourcing the most attractive niches for the business. Serving a particular group of segment simultaneously may not be manageable. Decisions about whether or not to withdraw from an unattractive and unprofitable segments may be overlooked, simply because of the mechanism to implement these decisions do not exist within the current organisation structures. Very often, financial institutions are not in the habit of linking customer attribute which determines profitability, such as propensity to buy certain product, propensity to "remain loyal" to the institution for a certain length of time, customer behaviour and customers attitude to their finances which drives such behaviour. There may also be a poor fit between the chosen segment and service provider's distribution strategy.

Although financial institutions are increasingly recognizing the importance of a strong customer focuses, radical changes to the organization chart have not necessarily been easy to implement. For example, some financial institutions have moved to form a matrix structure, where products and customers are given a more equal weighting, with product teams becoming champions for a particular customer groups, alongside their products responsibilities. Unfortunately, in some cases personnel have become unclear about their responsibilities and job priorities. The danger is that staff sees segmentation as an additional burden and are resistant to the culture change necessary to ensure successful implementation.

CONCLUSION AND RECOMMENDATIONS

Research findings support the notion that a range of barriers exist and the importance of these barriers varies in different organisation. Research evidence suggest that successful implementation is contingent on certain problems being overcome and that barriers exist which may inhibit the process. In view of diversity of insurance companies worldwide, the extent of barriers to segmentation may vary widely. Even different insurance company serving similar market may have differing experiences of segmentation implementation.

In collecting, managing and handling data, companies should seek to enjoy the benefits of a comprehensive and structured database. In doing so the companies should be able to take advantage of the buying behaviour data by developing a system that is responsive to the spending/saving patterns of

customers. By monitoring the pattern of customers individually and as a group, the insurance companies can learn some valuable lessons that can be used in their marketing effort.

An insurance company's view of marketing planning is one indication of the degree to which it is genuinely customer-oriented. As market segmentation is also a part of the marketing planning process, reviewing this aspect of strategic directions offers some interesting insights. There is considerable diversity in how companies deal with segmenting their customer base. The challenge is to use its detailed understanding of the customers spending/savings habit to systematically improve its marketing effort. The ready availability of demographic details of customers ought to enable most companies to work relatively simple forms of segmentation, based perhaps on customer age, income or social class. It is interesting to note that although evidence in the literature indicates that variables such as demographics are deficient when attempting to explain buyer behaviour for financial products (Brooks and White, 1996), and that lifestyle segmentation may be a more powerful predictor of customer behavior and product requirement (Hooley and Saunders, 1993), many financial institutions, including, insurance companies do not have the necessary information to apply lifestyle segmentation. This is partly because databases are usually "accounting" rather than "marketing" driven, including plenty of information on account balances, debit and credit but little evidence of lifestyle, interest or family circumstances. Some financial institutions are beginning to search for more sophisticated forms of segmentation based on attitudinal or psychographic data. They are seeking to fill the gaps in their database using a programme of customer interviews and questionnaires.

The development of a superior database can apparently impact on the type of segmentation activities that are possible. For example, the nature of a product to offer means that the financial service provider has access to a wealth of data on the customers spending pattern, which can reveal a great deal about lifestyle and habit of the individual. The need for some financial service providers to consider segmentation is even more pronounced where they are endeavouring to integrate their distribution channels, in order to provide an enhanced multi-channels service and to enable the rapid sharing of data across channels. In general, the evidence suggests that while financial institutions welcome the benefit that segmentation offers, the implementation of segmentation in practice meets with mixed success due to the barriers encountered. The consensus seems to be that success is more likely when segmentation programmes are implemented which are sympathetic to organisational characteristics, due realistically with

the current market situation, and yield easy to interpret segment (Webster, 1991).

FUTURES RESEARCH

Despite their attention that the literature has given to the application in the wider financial services sector, the implementation aspect and problems associated with it have been identified as key areas for future research (Speed and Smith, 1992). In order areas of marketing literature, similar concerns have been expressed, especially with the apparent prevalence of implement problems. Brown et al. (1989) identify missed opportunities resulting from unsystematic and inappropriate grouping of customers, a concern that has been echoed by other scholars. Although these concerns originate in different part of the literature, the links with issues raised by Speed and Smith (1992) seem almost uncanny. Concern has been expressed about the degree to which many managers understand and implement the segmentation concept. When taken as a whole, the literature seems to indicate that there may be a number of barriers that inhibit the successful implementation of the market segmentation process. For example, existing distribution systems, unorganised structure and existing relationship with intermediaries may make modified or new segmentation approaches difficult to implement.

Further research could still be taken in identifying the barriers which may affect the implementation of market segmentation and to consider how these may vary for different insurance organisation. Examining whether the presence of particular barriers impact the sophistication of market segmentation application.

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