CRITICAL QUESTIONS (AND ANSWERS) ABOUT LIFESTYLE SEGMENTATION FOR RETAILERS

TAS

Hartwell Hooper
Vice President of Client Success

Lorie Williams
Vice President of Consulting & Analytics

INTRODUCTION

The concept of lifestyle segmentation has been around for a long time. In fact, it was developed back in the 1970s. Since that time, there have been numerous examples of great successes as well as dismal failures. The result is that the reputation of lifestyle segmentation analysis is mixed, with some people swearing by it and others swearing they'll never try it again.

Lifestyle segmentation holds the promise of answering some otherwise difficult-to-answer questions. Because it clusters households into lifestyle segments, you can use it to meaningfully understand how each lifestyle segment behaves with respect to your retail concept. Behaviors like, how much a given lifestyle segment spends and what kinds of things they buy, can be measured. Since the systems are designed to let you identify where the lifestyle segments live, it becomes straightforward to zero in on the best opportunities.

The result is that you can easily answer otherwise tough questions like:

- Who are your best customer households and where do they live?
- Which customer households should you avoid?
- Which markets are best for your concept?
- Which areas of a given market have the highest concentration of demand for your concept?
- How should you size the departments of a new store at a given location?
- Which stores in your portfolio are most like this location?
- What will opening a store at a given location do to your online sales in that market?

For online retailers moving to brick & mortar stores, lifestyle segmentation can mean the difference between success and failure. Online retailers have great data about their customers' home addresses and purchase histories. These can be used to identify the best markets, sub-markets, and even sites for their stores before they even open one. After they have a portfolio of stores open, they can use lifestyle segmentation to determine the boost their online sales get from having a physical store in a market. Considering this effect can enhance overall performance significantly.

So, what's the deal with lifestyle segmentation analysis? What is it? And why are different companies experiencing such drastically different results? If you know the answer to three questions, you will understand what lifestyle segmentation is and how you can make it work for you. They are:

1. ***What is Lifestyle Segmentation?***
2. ***What are the Critical Factors for a Successful Lifestyle Segmentation Analysis?***
3. ***What Can You Do with Lifestyle Segmentation Analysis?***

Question 1:

What is Lifestyle Segmentation?

What is Lifestyle Segmentation?

A lifestyle segmentation system starts with defining clusters based on various factors, mainly demographic, life-stage, and urbanicity. Every household in the country is then assigned to one of these segments. The segments are usually given clever names that describe the households like "Couples with Clout" and "New Melting Pot." This means:

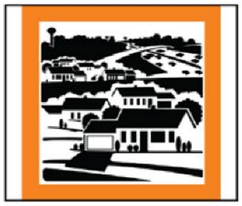
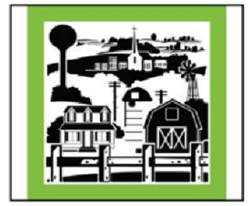
- You can take any address and determine its lifestyle segment
- You know how many segment households there are in each neighborhood in the country

The rationale of lifestyle segmentation is fairly simple:

> *By clustering households that are similar in their characteristics into lifestyle segments, the average behavior measured for a group belonging to a given segment will be the same for other groups of the same segment.*

What this means to retailers is that when they separate their customers into lifestyle segments and measure the average behavior of each segment, they can be reasonably certain that lifestyle segment households in areas the retailer is not currently serving will respond similarly to their concept. **So, knowing which lifestyle segments are your best customers in the markets you are currently serving can tell you where your best customers will be in the markets you are not currently serving.**

There are a number of different lifestyle segmentation systems available. Two of the most popular are Claritas Prizm and Experian Mosaic. Figures 1 and 2 illustrate their concepts.

URBAN	SUBURBAN	SECOND CITY	TOWN & RURAL
			

SOCIAL GROUPS

HIGH — $ — LOW

	URBAN	SUBURBAN	SECOND CITY	TOWN & RURAL
HIGH	**U1 URBAN UPTOWN** 04 Young Digerati 07 Money & Brains 19 American Dreams 21 The Cosmopolitans	**S1 ELITE SUBURBS** 01 Upper Crust 02 Networked Neighbors 03 Movers & Shakers	**C1 SECOND CITY SOCIETY** 22 Middleburg Managers 33 Second City Startups 37 Bright Lights, Li'l City	**T1 LANDED GENTRY** 05 Country Squires 09 Big Fish, Small Pond 11 Fast-Track Families 15 New Homesteaders
	U2 MIDTOWN MIX 17 Urban Elders 31 Connected Bohemians 35 Urban Achievers 40 Aspiring A-Listers	**S2 THE AFFLUENTIALS** 06 Winner's Circle 08 Gray Power 10 Executive Suites 12 Cruisin' to Retirement 13 Upward Bound 14 Kids & Cul-de-Sacs 16 Beltway Boomers	**C2 CITY CENTERS** 47 Striving Selfies 48 Generation Web 49 American Classics 53 Lo-Tech Singles 54 Struggling Singles	**T2 COUNTRY COMFORT** 18 Mayberry-ville 23 Township Travelers 24 Pickup Patriarchs 27 Big Sky Families 28 Country Casuals 29 White Picket Fences
$	**U3 URBAN CORES** 42 Multi-Culti Mosaic 43 City Roots 45 Urban Modern Mix 56 Multi-Culti Families 63 Low-Rise Living	**S3 MIDDLEBURBS** 20 Empty Nests 25 Up-and-Comers 26 Home Sweet Home 30 Pools & Patios	**C3 MICRO-CITY MIX** 59 New Melting Pot 61 Second City Generations 64 Family Thrifts 66 New Beginnings 67 Park Bench Seniors	**T3 MIDDLE AMERICA** 32 Traditional Times 38 Hometown Retired 39 Kid Country, USA 44 Country Strong 46 Heartlanders 51 Campers & Camo 52 Simple Pleasures
LOW		**S4 INNER SUBURBS** 34 Young & Influential 36 Toolbelt Traditionalists 41 Domestic Duos 50 Metro Grads		**T4 RUSTIC LIVING** 55 Red, White & Blue 57 Back Country Folks 58 Golden Ponds 60 Small-Town Collegiates 62 Crossroad Villagers 65 Young & Rustic 68 Bedrock America

Figure 1. The Claritas Prizm Premier Lifestyle Segmentation system

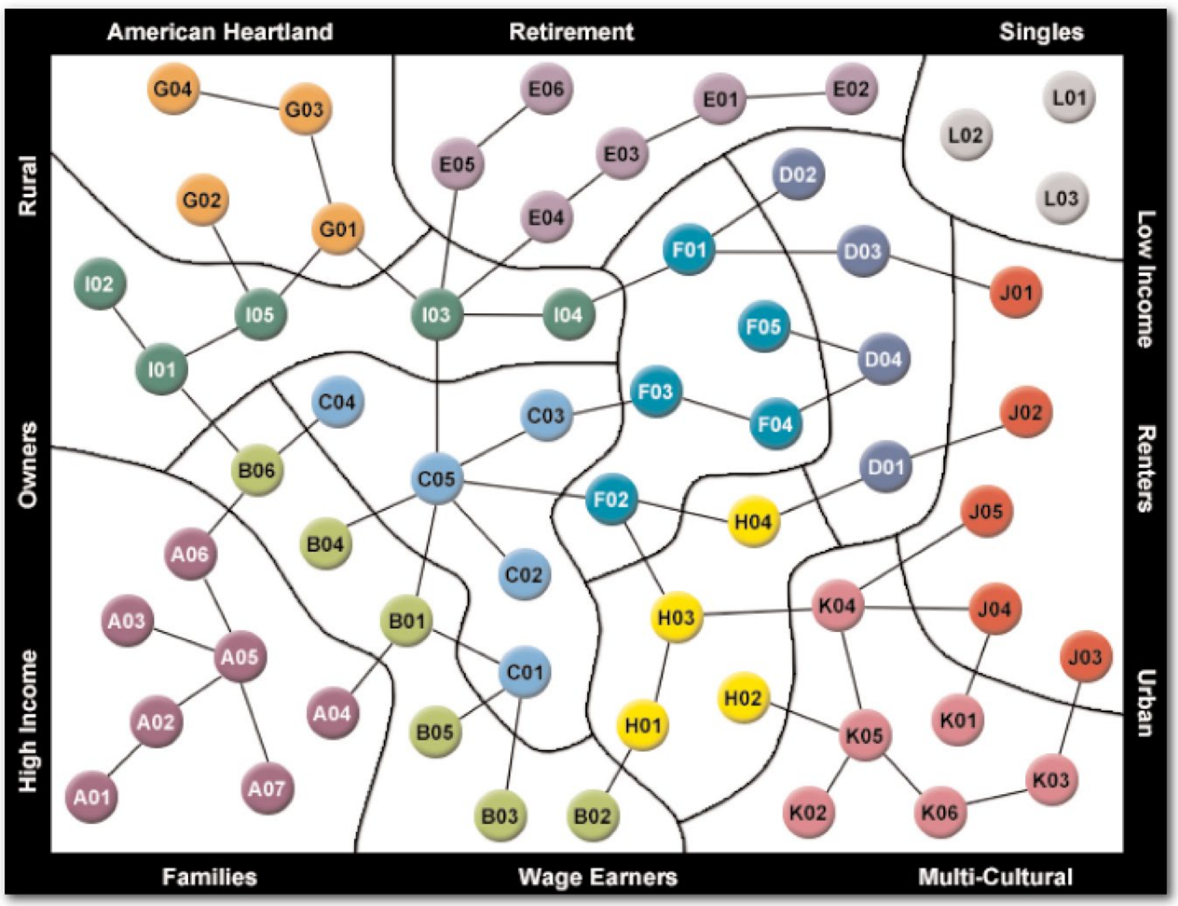


Figure 2. The Experian Mosaic Lifestyle Segmentation System

Question 2:

What are the Critical Factors for a Successful Lifestyle Segmentation Analysis?

What are the Critical Factors for a Successful Lifestyle Segmentation Analysis?

The main reason that lifestyle segmentation has a spotty reputation is that many times it is just done wrong. Let's walk through the right and wrong way to perform each step.

ACCESS TO GOOD QUALITY, MEANINGFUL CUSTOMER DATA:

Best: You have access to your customers' purchase histories by department and home addresses.

Very Good: You have access to your customers' purchase histories and home addresses.

Good: You have access to your customers home addresses. If you do not have a customer loyalty program, massive mobile data can be used, as it typically provides a home latitude and longitude. However, the latitude and longitude are not exact so there are some potential issues with the quality of the lifestyle coding.

Poor: You have no customer data.

If you do not know where your customers live, there is no way to meaningfully identify their lifestyle segment. If you know where they live, you can identify their lifestyle segment and assess their propensity to shop at your store. If you also know what they spend, you can assess which lifestyle segments spend the most. If you know what they spend their money on, you can assess how departments should be sized and even gain some insights into profitability (assuming some departments are more profitable than others).

Many retailers have great customer data for their online sales. This is extremely helpful in producing a meaningful lifestyle segmentation analysis.

DEEP DIVE

What is a block group?

A block group is a geographical area (zip codes, counties, states, etc. are other types of geographical areas) used by the United States Census Bureau. It is the smallest geographical area for which the Census Bureau publishes sample data. That is, data that's only collected from a fraction of all households. Typically, block groups have a population of 600 to 3,000 people. Many people think of them as similar to large neighborhoods or "sections of town."

TAS

IDENTIFYING THE LIFESTYLE SEGMENTS OF YOUR CUSTOMERS:

Best: You use customer addresses to determine the lifestyle segments at the household or zip+4 level.

Poor: You use customer addresses to match the dominant segment at the block group level.

Very Poor: You use the dominant segments at the block group level around your store to infer the lifestyle segments of your customers.

Not surprisingly, the more precisely you identify the lifestyle segment of your customers, the more accurate the results of the analysis will be. However, accuracy costs money. And while you can never go wrong with more accuracy, if you have a lot of customer data the slightly reduced accuracy of a zip+4 match versus a household-level match may be worth the cost savings, especially if you have a lot of customers.

Matching at the dominant segment level is almost never a good idea (see Deep Dive on Dominant Segment, below). It really tells you very little about the true nature of your customers. And determining which lifestyle segments are your customers without customer data by simply looking at the dominant segments around your store is very ineffective.

DEEP DIVE

What do we mean by "Dominant Segment" in a block group?

A block group is like a neighborhood; it's a relatively small area of geography. The suppliers of lifestyle segmentation data have an estimate of how many households in the block group belong to each of the lifestyle segments.

It may look something like this

Segment 5:	*475*	*Households*
Segment 11:	***700***	***Households***
Segment 22:	*275*	*Households*
Segment 25:	*625*	*Households*
Segment 31:	*425*	*Households*
TOTAL	***2,500***	***Households***

In this example, Segment 11 is the dominant segment because it has more households associated with it than any other segment. But Segment 25 isn't far behind and the probability of a given household in the block group belonging to Segment 11 is 700 / 2500 = 28% - well below 50%. So approaches that assign households to the dominant segment of a block group rarely work well.

CORRECTLY SELECTING THE CUSTOMERS TO INCLUDE:

Best: You develop a process for defining meaningful study areas around each of your existing stores (typically including between 70% and 80% of your customers) and only include customers from inside the study area. See Figure 3.

OK: You use a consistent study area for every store (e.g. a 5 mile ring) and only include customers from inside the study area.

Poor: You include all customers in your analysis regardless of where they come from.

Figure 3. Using Study Areas to limit analysis drastically increases the accuracy of lifestyle segmentation analysis

While it may seem wasteful to exclude customers from your lifestyle segmentation analysis, the truth is that customers from too far away can actually reduce the accuracy of your analysis. The reason for this can most clearly be seen in the next step when you weight the customers based on the underlying households.

This is one of the most difficult aspects of a solid lifestyle segmentation analysis and many skimp on it, which negatively impacts the accuracy of the analysis.

For online-only retailers, this step does not apply. The entire country is being served by them, albeit, at a reduced capacity to a physical retailer. Online-only retailers are weighted by the household counts for the entire country.

ASSESSING THE IMPORTANCE OF EACH LIFESTYLE SEGMENT:

Best/Very Good: You assess the expenditure by department or, if not available, the total expenditure for each lifestyle segment.

Analyzing lifestyle segments by their expenditure is the best way to truly understand who your best customers are. Two segments may shop your store at the same frequency, but if one spends, twice as much as the other on average, which would you prefer to locate near?

Expenditure Index

Lifestyle Segment	Total Customer Expenditure ($1,000s)	Percent of Total Customer Expenditure %CE	Households in Study Area	Percent of Study Area Households %SAH	Expenditure Index EI
3	$ 82,891	6.8%	862,063	1.6%	436
12	$ 217,313	17.9%	9,975,000	18.1%	99
19	$ 74,825	6.2%	5,782,452	10.5%	59

Figure 4. Calculating Expenditure Index by Lifestyle Segment

In the example shown in Figure 4, almost 18% of sales come from lifestyle segment 12 and they are roughly 18% of the households in our study areas. So, we are doing "as expected" with this lifestyle segment. However, lifestyle segment 3 is 6.8% of our sales but only 1.6% of our households. We are doing more than four times better than average with them. We should be seeking these lifestyle segments in future site selection.

Even better is to assess expenditure by department. Not all customers are created equal. Often times, certain segments will spend differently than others. Understanding these differences can give you "x-ray vision" into the natures of markets and sub-markets, allowing you to find the best sites and then properly size departments before you open the stores.

DEEP DIVE

Calculating Expenditure Indexes

Calculating indexes for lifestyle segments is really not complex. The idea is to do the following:

1. *Calculate what percentage of your customers' expenditure (from the study area) come from each segment. This is **%CE** in Figure 4.*
2. *Calculate the percentage of households (customers and non-customer) from each lifestyle segment in the study area. This is **%SAH** in Figure 4.*
3. *For each lifestyle segment, to find EI, divide %CE by %SAH and multiply times 100.*
   a. *If the number is equal to 100, then your percent of sales from the lifestyle segment is equal to their percentage representation in the study area so they are "average."*
   b. *Significantly above 100 means you are overperforming with that lifestyle segment.*
   c. *Significantly below 100 means you are underperforming with that lifestyle segment.*

ASSESSING THE IMPORTANCE OF EACH LIFESTYLE SEGMENT:

Good: You assess the number of customers for each lifestyle segment. This works the same as Expenditure Indexes but we just count the number of customer households that shop us instead of the expenditure and compare that to the underlying households in the study area. Understanding which households have a higher propensity to shop your concept, while not as good as understanding expenditure, is a big step in the right direction.

Household Index

Lifestyle Segment	Total Customer Households	Percent of Total Customer Households %CH	Households in Study Area	Percent of Study Area Households %SAH	Customer Household Index CHI
3	66,313	3.1%	862,063	1.6%	198
12	356,251	16.6%	9,975,000	18.1%	92
19	299,300	13.9%	5,782,452	10.5%	133

Figure 5. Calculating a Household Index by Lifestyle Segment. Note that Expenditure Index analysis and Household Index analysis can lead to different conclusions. In this case Segment 12 beats 19 in the Expenditure Index Analysis with an index of 99 versus 59, but does not in the Household Index Analysis where it trails 92 to 133. For retailers that do not have expenditure data for brick & mortar stores, online sales data can help to refine this analysis.

Group	Segment	Customer Households	% Customer Households
A	1	135,729	3.8%
A	2	120,833	3.4%
A	3	110,521	3.1%
A	4	146,042	4.1%
B	5	114,583	3.2%
B	6	127,104	3.5%
B	7	114,583	3.2%
B	8	104,167	2.9%
C	9	197,917	5.5%
C	10	250,208	7.0%
C	11	312,708	8.7%
C	12	593,750	16.6%
C	13	458,542	12.8%
D	14	229,167	6.4%
D	15	271,146	7.6%
D	16	189,792	5.3%
E	17	31,042	0.9%
E	18	46,042	1.3%
E	19	19,063	0.5%
E	20	13,542	0.4%
TOTAL		**3,586,479**	**100.0%**

Figure 6. The wrong way is to simply calculate the percent of your customers from each lifestyle segment and then stop.

Very Poor: You calculate the percentage of each lifestyle segment that makes up your customer base without weighing it for their presence in the study area. You can easily fool yourself into thinking that your best customers are the one that are simply have the greatest number of households in your markets. Very often, this not the case.

Merely seeing that 20% of your customers come from Segment 7 tells you nothing. What if they are 30% of the households in your study area? Then you are actually underperforming with respect to this segment.

Note that using this approach with expenditure data is not much better.

SUMMARY OF APPROACHES TO LIFESTYLE SEGMENTATION

Best: You weight the expenditure by department for each lifestyle segment by the presence of those lifestyle segment households in your study areas.

Very good: You weight the total expenditure for each lifestyle segment by the presence of those lifestyle segment households in your study areas.

Good: You weight the number of customers for each lifestyle segment by the presence of those lifestyle segment households in your study areas. This is appropriate if you do not have customer loyalty data and you are working with data sources such as massive mobile data that does not contain expenditure data.

Very Poor: You calculate the percentage of each lifestyle segment that makes up your customer base without weighting it for their presence in the study area.

Question 3:

What Can You Do with Lifestyle Segmentation Analysis?

What Can You Do with Lifestyle Segmentation Analysis?

Once you understand how each lifestyle segment responds to your concept, it will give you great power to understand your current customers as well as people in markets where you haven't yet opened stores.

By understanding how various lifestyle segments respond to your concept, you can easily answer many previously difficult questions.

- Who are your best customers and where do they live?
- Which customer households should you avoid?
  - Paying rent for access to households that don't prefer your concept produces poor return on investment. A solid lifestyle segmentation analysis helps you avoid areas that are dense with your poor performing segments.
- Which markets are best for your concept?
  - Because we know where the households from each lifestyle segment are "on the map," it's easy to identify the markets that have the most potential for your concept.
- Which areas (sub-markets) and sites in a given market have the highest concentration of demand for your concept?
  - Similarly, you can use the knowledge of where your best lifestyle segments live to find the best locations in the best markets.
- How should you size the departments of a new store at a given location?
  - If you have analyzed your customer based on expenditure by department as described in Question 2, Section D, you can project with surprising accuracy how the demand will be distributed between departments. Knowing this lets you size departments appropriately during the design phase.
- Which stores in your portfolio are most like this location?
  - By looking at the lifestyle segmentation of the households in the projected trade area of a site and combining that information with some other relevant information about the site, you can identify stores in your current portfolio that most match the site. If those stores perform well, you can have more confidence that it is a good site.
- Which stores in your existing portfolio seem to be underperforming based on the potential of their trade areas?
  - Lifestyle segmentation analysis lets you quantitatively understand the quality of the customer base around each store in your portfolio. By comparing the quality of the customer base to the performance of each store, you can identify underperforming stores that would otherwise be invisible or at least hard to assess. This lets you focus on taking action where there is the most opportunity for upside.
- What will opening a store at a given location do to your online sales in that market?
  - It has been shown conclusively that having a physical store in a market increases online sales. But typically, the impact is different for different lifestyle segments. Understanding this and using it in site selection can significantly improve overall performance.

AREAS OF CAUTION

Segmentation analysis offers benefits to companies trying to better understand the characteristics of their customers. Whether you're expanding into new territory, assessing opportunity for a new product launch, or tailoring the next big marketing message, everyone will admit, some insights are better than no insights. However, as with any analysis, this is only one tool in the decision-making toolbox. As you evaluate the necessity for lifestyle segmentation keep a few things in mind:

1. **What happened here may not happen there:** Although you may have identified your core segments consider additional factors in new markets that may cause those customers to act differently, for example:
    a. Brand awareness: Just because certain segments love you in your home market doesn't mean they will immediately love you in a new market.
    b. Attainable opportunity: While the overall opportunity in a market may be large, the ability to actually capture those dollars is specifically dependent on the competitive layout, site location opportunities, and purchasing behaviors for your product category.
    c. Competitive dominance: Is there a competitor in the new market that you've not gone up against before? If so, can you attract their customers away?
    d. Different weather: If you appeal to people in Minneapolis for your winter outerwear, you may have a different experience in Atlanta.
    e. Different historical ethnicities: Historical ethnicities of markets can impact preference and demand in ways that lifestyle segmentation does not capture. For example, men's big & tall stores avoid area with ethnic backgrounds that tend to be shorter. Certain food preferences may be impacted by traditional regional cuisines.
2. **Be Aware of Your Data:** Ensure you understand the quality of your data can influence your results.
    a. Do I have enough data to represent my customer base?
    b. Am I using data from visitors (mass mobile) or customers?
    c. Do I have actual expenditure data?
    d. How old is my data?

AREAS OF CAUTION

3. **Outliers of Location:** No matter how well your predictive accuracy is or how confident you are in the customer segmentation there are outlying factors that can influence performance including:
    a. The quality of store management
    b. Construction
    c. Co-tenancy
    d. Quality of real estate
    e. Convenience
    f. Adjacency to primary segments
    g. Local economic factors
4. **Don't be one and done:** Customer preferences change over time. Ensure that conducting your first segmentation analysis isn't your last. Continue to evaluate your expanding customer base on a consistent basis, especially as you grow your store count, brand, and product changes.

CONCLUSION

Lifestyle segmentation is an extremely powerful tool for the retailer that informs many aspects of their business. However, it needs to be done correctly in order to produce meaningful results.

When done right, the retailer gains incredible insights into markets, sub-markets, sites, online retailing, and even their existing stores. The return on investment on a properly done lifestyle segmentation analysis is tremendous. However, the return on investment for a poorly done analysis can actually be negative because, when done wrong, it can lead retailers to make decisions that are worse than they would have made without the analysis.

So, if you have good data, there is probably no scenario where a lifestyle segmentation analysis won't pay dividends. Just be sure to do it right or find someone that can.

ABOUT THE AUTHORS

Hartwell Hooper

With nearly 30 years in the industry, Hartwell is recognized as an expert in retail location analytics and modeling. He led real estate analytics teams at Wachovia Bank and CVS Caremark. He has Master's Degrees in both Geography and Finance and is a frequent speaker at industry events.

Lorie Williams

Lorie joined TAS after leading market strategy efforts at Family Dollar for 10+ years. She led teams responsible for analytics, technology and strategic planning during Family Dollar's record store growth years. She has significant experience in real estate life cycle and portfolio management. Lorie has Bachelor's and Master's Degrees in Geography.