Market segmentation has both strategic and operational dimensions. As a strategic decision, segmentation involves the determination of the characteristics and number of segments for which to develop distinct marketing programs for a product market entry. As an operational decision, segmentation involves the allocation of resources across these segments so as to optimise some objective (e.g., profit or sales). In principle, both of these decisions can be treated as static policy choices or as more dynamic processes. In principle, either strategic or operational market segmentation from either a static or dynamic standpoint could be “grounded” in some theory of competition. The problem is to match the right class of segmentation decision with the right class of competition “theory.” There are a number of possible candidates for a useful theory of competition in this context. The essay in this issue of *amj* by Hunt and Arnett considers two of these: 1) the implicit competition theory found in the neoclassical theory of market heterogeneity and product differentiation along with its closely related cousin, the theory of price discrimination and 2) the resource-advantage (R-A) theory of competition. Their essay broadly critiques the grounding value of the former candidate and broadly favours the candidature of the latter, that is, the R-A theory. Although there are a number of potentially more valuable alternative candidates (e.g., game theoretic models as well as dynamic multiple competitive reaction models), since Hunt and Arnett (2004) choose to position R-A theory as a superior alternative only in comparison to neoclassical economic perspectives, this commentary will similarly restrict its scope to that particular debate in this marketplace of ideas.

Hunt and Arnett (2004) review the basic arguments and conditions that favour a market segmentation strategy. They use three brand lines from Black and Decker as a continuing example. They try to argue that market segmentation, to be effective, must be “grounded” in some theory of competition and find the R-A theory of competition to be particularly appropriate for this purpose. Many of the observations about market segmentation raised in their article reflect mainstream thinking in marketing and probably will come as no surprise to most marketing scholars. Nevertheless, their article seems to have two implicit objectives for extending our understanding of segmentation phenomena. The first is to “ground” some basic segmentation principles in a relevant competition theory, here R-A theory. The second is to argue against neoclassical economics’ tendency to downplay market heterogeneity and to characterise segmentation policies that attempt to capitalise on heterogeneity (particularly with regard to explicit or implicit price discrimination) as having adverse welfare effects.

Hunt and Arnett (2004) claim that neoclassical economics tends to view heterogeneous demand as largely an artificial creation of marketers whilst marketing theory treats such heterogeneity as naturally occurring and as eliciting socially beneficial marketing efforts to satisfy diverse segments of customer demand. The resulting caricaturisation depicts neoclassical economics as condemning sellers’ efforts to capitalise on demand heterogeneity particularly via price discrimination. But few if any marketing scholars now subscribe to the idea that price discrimination is a crude “indicator” of monopoly power and, as such, somehow anti-competitive and anti-social. On the contrary, segmentation, when viewed specifically as the potential to extract consumer surplus across segments with differing demand (and valuations), can quite reasonably be viewed as a distinct source of (or mechanism for achieving) competitive advantage (see, for example, Davis and Devinney 1997). And there is little support amongst, for example, American marketing scholars for archaic and infrequently enforced anti-price discrimination legislation (such as the
US Robinson-Patman law). In these senses, Hunt and Arnett’s (2004) depiction of the neoclassical view comes across as a bit of a straw man.

The more serious question Hunt and Arnett raise for marketing scholars is whether and how the R-A theory of competitive advantage adds value to any basic theory of segmentation. Yet, many of their observations do not venture beyond basic principles regarding segment size, market heterogeneity, distinctive product offering value, and cost. These principles can be found in most basic textbook checklists. Thus, for example, in Section 5, Hunt and Arnett state that

...a market segmentation strategy will be more successful... when (1)...demand is substantially heterogeneous, (2) the target segment demand is relatively large (or has a large growth potential), (3) a firm’s market offering is well-tailored to a target segment’s taste and preferences, (4) competitor’s offerings are not well-tailored to each segment, and (5) given that a firm’s market offerings are viewed as equal or better than the rival’s market offerings...the firms resource costs... [are lower than competitors]

It is difficult to imagine how anyone would argue with such well-accepted principles. Thus, there is a serious question as to whether R-A theory, as used by Hunt and Arnett (2004), constitutes a worthwhile theory of competition and competitive advantage or amounts to little more than a rather trivial set of principles about market demand, resource cost and comparative advantage. Rather confusingly, in section 3, Hunt and Arnett claim that “...when firms have a comparative advantage (disadvantage) in resources, they will occupy marketplace positions of competitive advantage (disadvantage).” (emphases mine). Yet, arguably, for cost to be a sustainable basis for competitive advantage, it is insufficient for it to be based on a static comparison of resources but rather on unique and non-imitable economies of scale, scope, or experience (an issue discussed at some length in Davis and Devinney 1997).

More to the point with regard to market segmentation, the classic treatise by Frank, Massy and Wind (1972) and subsequent work by Massy and Weitz (1977) clearly show that it is mix tool response heterogeneity that is the conceptual basis for a normative theory of market segmentation. Such a theory clearly and explicitly incorporates optimal allocation rules in a manner analogous to rules for optimal price discrimination. However, as such, that theory wasn’t really a theory of segmentation as a strategy but was simply an operational theory of cross-segment resource allocation (since strategic choices by definition are not subject to optimisation rules). Nor, of course, was it based on a theory of competition. Thus, Hunt and Arnett (2004) are quite correct that we could need a better theory of segmentation as strategy, particularly one with a competitive strategy basis. While this is an admirable research agenda, the particular proposal presented in their article seems to fall short of this ambition. The “competitive matrix” presented by Hunt and Arnett and the application of R-A theory don’t seem to have enough power to truly “ground” segmentation theory, although this itself is a rather amorphous objective. There are probably several reasons why. One may be that R-A theory is a theory of firm resources and corporate competitive advantage whilst market segmentation theory is a theory of marketing strategy at the level of the product market entry. Thus links between the two will yield only fairly superficial generalisations. It is not surprising, therefore, that Hunt and Arnett tend to make fairly trivial and even trite conclusions (“a firm will have a disadvantage in a given segment, if it produces (1) a market offering perceived as having lower value compared to rivals’ market offerings at the same cost as rivals...” (Section 4). They inadequately and too casually treat the admittedly slippery R-A concept of “competitive advantage” and too simplistically apply it to segmentation policy. For example, they assert that

R-A theory maintains that firms that are successful in developing market offerings that provide more value to consumers in specific market segments and/or provide market offerings at a lower cost (relative to competitors) will occupy marketplace positions of competitive advantage. In turn, positions of competitive advantage lead to superior financial performance. (Section 4)

These sweeping yet apparently plausible assertions could fail to capture the essence of “competitive advantage” even from an R-A perspective. Most analysts argue that for a resource to be strategically valuable and to yield a sustainable competitive advantage, it should be unique and nonimitable, and may further benefit from such important (R-A) characteristics as path dependency and rent appropriability (by the owning firm). To simply offer superior value to a “target segment” at lower cost than competitors is such a widely held yet elusive aspiration that it fails to meet such criteria. It is hardly a unique or nonimitable competitive strategy. It’s not even clear that it is a strategy at all.
Finally, by using the Black and Decker example, Hunt and Arnett (2004) implicitly obfuscate the distinctions between target market selection, competitive positioning, and market segmentation. Arguably, one could more productively and realistically view the three brand lines (B&D, Firestorm, and DeWalt) as being targeted at three distinct markets (not “segments” as such) and as having three distinct positioning strategies relative to competitors within in these same three product markets. That is, B&D has a certain positioning within the DIY market (against other DIY brands) and DeWalt has its own positioning within the “Professional” market (against other professional brands). The choice of competitive positioning within these markets is certainly a matter of competition-based segmentation strategy. But these two markets are not in competition with each other. Competition occurs within them. For example, in a recent print advertisement in Australia, a power drill in the professional DeWalt range is advertised at a price of over ten times that of a typical DIY model. That kind of difference isn’t simply a price point distinction aimed at extracting consumer surplus from market segments with differing mean reservation prices. More likely, it indicates that the two product ranges are developed for two totally distinct underlying target markets (and, hence, compete in two distinct competitive product markets). Thus, the so-called “strategy” of having three brand lines competing in three product markets is not a competitive strategy as such. It is simply a product-market portfolio choice. Furthermore, a pure (non-competition based, product-tool level) segmentation “strategy” for, say, the DeWalt line would involve policies about the number of variants in the line (eg, price points of drills) within that brand range rather than policies about the portfolio of non-competing brands. Unfortunately, such obfuscation of strategic levels of analysis is quite common if not endemic in some circles. It permeates far too many of our marketing textbooks. To that extent, Hunt and Arnett can be forgiven. However, any incrementally useful “grounding” of segmentation theory in a theory of competition must operate at the level of underlying market strategies for a product market entry, not at the well-worn and fairly well-understood level of a business’s portfolio of branded product market entries itself.

Furthermore, Hunt and Arnett’s discussion (Section 5.1) on resource set and segmentation strategy fit appears to be really concerned with market selection or entry because the only “segmentation strategy” considered is whether to enter particular markets. A discussion of target market selection or entry would be quite fine if that were the scope of their article and its claims, but, unfortunately, it clearly is not. Instead, they claim to be treating segmentation (quite properly) as the development of different mixes for different segments (which they must be, in the first instance, to be consistent with their welfare discussion of price discrimination). But segmentation in the latter sense is vastly different from (target) market selection or entry. Thus, for example, it is rather surprising that the authors assert in their conclusion that segmentation (multiple mixes) induces innovation (in some entrepreneurial sense). This conclusion is not supported by any plausible arguments or evidence in their article. In fact it is probably quite wrong. Rather, the kind of resource set that fits a segmentation strategy (specifically for multiple product segmentation) is one of flexible manufacturing rather than product innovation, precisely because flexible manufacturing allows the firm to get a cost advantage otherwise available to competitors with higher share and scale pursuing a mass market (ie, non-segmentation) product strategy. But as one analyst argues,

Flexible manufacturing is not new product introduction or target market selection; once implemented, it does not affect product market structure. The management of diversity is not the creation of change.

...the selection by a firm of target markets to pursue involves the selection of customers and customer uses to satisfy; such selection is quite strategic and entrepreneurial. (Cadeaux, 1997, p. 777)

In the latter sense, target market selection, in contrast to product segmentation, does involve the dynamic process of matching changing assortments of products and services with changing arrays of customer wants (Alderson 1957, 1965, Reekie and Savitt, 1982, Dickson 1992). In that sense, target market selection has already been “grounded” in something quite close to an R-A theory of competition (that is, Alderson’s dynamic marketing theory and Dickson’s theory of “competitive rationality”). In that sense, and in contrast to market segmentation, target market selection, as an entrepreneurial action, could, in and of itself, be a pure source of competitive advantage. Importantly, Hunt and Arnett (2004) argue that R-A theory accepts as its premise that intra-industry demand is heterogeneous. This assumption has also been the basis for the so-called “Austrian” approach to entrepreneurial theory in marketing (Reekie and Savitt 1982). In that sense, R-A theory along with neo-Austrian approaches (such as Dickson 1992 and others) does in fact “ground”
competition theory in a theory of market heterogeneity (or segmentation), but by doing so it does not say anything about the implied converse: that is, it does not, in itself, help “ground” a theory of market segmentation in a theory of competition.

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Biography


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