

STEP I

Market Segmentation

WHAT IS STEP I, MARKET SEGMENTATION?

Brainstorm how your idea or technology can serve a variety of potential end users. Narrow that list of potential end users to several promising categories, then conduct primary market research to gain more information about each potential end user.

WHY DO WE DO THIS STEP, AND WHY DO WE DO IT NOW?

It is crucial to start the process with a focus on a target customer. Everything else about your business will be based on that focus.

By the Book: See pages 23–35 of *Disciplined Entrepreneurship* for basic knowledge on this step. See pages 36–39 of *Disciplined Entrepreneurship* for an example of how a company addressed this step.



Seeing the world
through
the eyes of the
customer

vs.



Seeing the world
through
the perspective
of the company

The Market Segmentation step gives you the right frame of mind for the new product right from the start.

PROCESS GUIDE

The single necessary and sufficient condition for a business is a paying customer. If people don't give you money in exchange for your product, nothing else matters. As I discuss in *Disciplined Entrepreneurship*, the best way for an innovative startup to lay the groundwork for a solid company is to dominate a narrow, carefully defined market that serves a particular end user. To choose the best market, you'll do a Market Segmentation that uses primary market research to pinpoint the best markets to draw your attention. Later, you'll select one of these markets and dig deeper in the process of determining exactly who your customer will be.

An end user (the foundation of a market segment) is a category of people who have similar needs and customer pains. End users typically have similar demographics and other characteristics. Rigorously categorizing end users, which is what you want to do, is much more detailed than you may think. For instance, an education startup would be poorly served by targeting the general category "teachers" as their end users, as it is too general. This general description ignores the differences between public and private schools; primary, secondary, and postsecondary education; rural, suburban, and urban school districts; and young, inexperienced teachers and older, veteran teachers.

In this workbook, you'll go through the three stages of Market Segmentation—brainstorming, narrowing, and primary market research.

Part IA: Brainstorming

"I already have my idea. Why do I need to brainstorm again?"

The idea or technology is a good starting point because it reveals your interests, skills, passions, and possibly key assets. But it often does not articulate systematically enough a customer pain, a need that is so deep that a group of people are willing to pay you a meaningful amount of money to solve it. The Market Segmentation's brainstorming stage is designed to broaden the world of possible end users as wide as possible to consider who might benefit from your idea.

Often some of the most interesting Beachhead Markets exist on the fringe of the spectrum and are overlooked by others, so think broadly. Wild ideas are welcome and encouraged at this point.

How do you effectively brainstorm so that you are considering all the possibilities? Keep these tips in mind:

1. **Get the right people in the conversation:** You should discuss with not just your founders, but also consider other relevant parties such as domain experts, technologists, creative types, facilitators, and others you deem appropriate. It is helpful to have many of these people in a room together brainstorming, but don't expect to lock yourselves in a room for a single session of a few hours and have a completed list; you also want to bounce ideas off of potential customers and others you know or can get connected to. To get the best portfolio of options, it will probably take multiple meetings in multiple different locations with multiple different audiences within the time frame you have available for your situation. Don't let the discussion be constrained by the technology available today. If anything, expand your horizons and consider trends in technology and even brainstorm the possibilities if technology advanced even faster.

2. **Be clear on the dual purpose of the brainstorming:** You want to get the right people in the conversation because you're not just making a comprehensive list of potential markets. You're also selecting and refining your initial team and then creating alignment for that foundational team. Some of the people you invite to the conversation will become cofounders, and depending on how the conversation goes, some of your current cofounders may drop out. This is natural and healthy if you are executing the process effectively. Cohesion comes from all the members of the team participating in the formation of your organization and understanding its direction. Just knowing the final answer is not as empowering as deeply understanding why the answer was agreed upon.
3. **Get in the right place with the right tools:** Find a new place where everyone feels comfortable because it is important that constraining hierarchical relationships and distractions are eliminated or at least kept to a minimum. Disconnect from all e-mails, texts, tweets, and other notifications for at least a half day—a full day is better. Get a lot of sticky notes and encourage participants to jot down ideas as they come up with them and then share them. If you can find a space with whiteboard or chalkboard walls, even better.
4. **Get the right rules to brainstorm by:** The renowned design firm IDEO has five basic rules that govern brainstorming sessions. While others have used variants of this and customized them to their environment (quite colorfully and memorably), IDEO's rules that can be used as a starting point are:
 - a. Defer judgment
 - b. One conversation at a time
 - c. Stay focused on the topic
 - d. Encourage wild ideas
 - e. Build on the ideas of others
5. **Identify, empower, and develop a facilitator:** Find or appoint a facilitator to enforce the rules you agree to in #4 above, and empower that person to guide the process. That person should take this responsibility seriously and prepare for the session. It is their responsibility to ensure everyone gets input and to avoid groupthink or dominant personalities controlling the conversation.
6. **Get everyone in the right mood:** As discussed in Step 0 of this workbook, getting people in the mindset of “yes, and...” is incredibly important. The night before the brainstorming session, I strongly suggest having participants watch the brainstorming part (approximately the first third) of ABC News *Nightline*'s segment “The Deep Dive” about IDEO; you can find this video online. On the day of the brainstorming session, start out with David Morris's 11-minute TEDxVictoria talk on “The Way of Improv,” also available online. The participants will hopefully be laughing by now and more relaxed than usual. The facilitator should then explain the key points of the David Morris video and how that builds off the IDEO video and is relevant to the exercise of the day. The fundamental concept of saying “yes, and...” has helped so many of my interactions with students and entrepreneurs to make situations much more productive.
7. **Focus on being specific:** The “F” word for entrepreneurs is “focus,” because it's hard to do, and entrepreneurship requires continually keeping your focus. Make sure everyone understands they are brainstorming potential end users, and have them review Step 1 of *Disciplined*

Part 1B: Narrow

Now that you have lots of ideas, it is time to start narrowing down the field to eliminate from consideration market segments that would be weak options for your startup. The goal is to get to a manageable list so that later you can do a deeper analysis on a small number of market segments before you choose your Beachhead Market. I would say anywhere from four to 10 markets is a reasonable number of candidates to end up with, so that you can build your first draft Market Segmentation Matrix in Part 1C of this step.

Use the seven questions in the chart below as a guide for your discussions. Refer to Step 1 in *Disciplined Entrepreneurship* if you need more detail on how to answer those questions.

Start by focusing on your team's values, passions, and goals, and eliminate ideas that violate your values. Don't ignore your passions, because you will not be successful if you do something you do not like. You will probably also have some subset of ideas that the team quickly decides are not worth pursuing.

Each time, before you eliminate a market segment, allow time for the group to discuss to make sure the group has all the information before making such a decision. This discussion can be a powerful learning and alignment process. Lastly, once the obvious candidates are removed, have the group vote on the remaining market segments to get a prioritized list.

Use the chart below to record your prioritized list of top market segments and why they are particularly compelling. Record a sentence or two explaining each question on the chart. If, while filling out this chart, your team realizes another market segment is more compelling, discuss with the group whether to switch it out on your short list of candidates. Then, use the "Rank" column to prioritize each end user by how compelling an opportunity you think it is ("1" is best).

Top Target Markets to Consider for My Startup

End user	Target customer well-funded?	Target customer readily accessible to sales force?	Target customer's compelling reason to buy?	Can you deliver a whole product?	Is there entrenched competition?	Can you leverage this segment to enter others?	Consistent with values, passions, goals of team?	Rank

Part 1C: Primary Market Research and Market Segmentation Matrix Version 1.0

Now that you have narrowed your market segments to a manageable number, you will start doing primary market research to build out the Market Segmentation Matrix below. You may be tempted to fill in the matrix with what you already know, but I urge you to be patient.

Instead, gather nearly all of the information through primary market research, by interacting directly with potential customers how they work today and what their customer pains are. Don't assume you have the answer for a customer and start advocating your ideas. Instead, stay firmly in "inquiry mode" and learn from the customer. You will discover lots of things you don't know about the customer's needs, and you may find reason to revise your end user market segment definitions.

Before starting your primary market research, each person working on the matrix should read and understand the next chapter in this workbook, "A Practical Guide to Primary Market Research," and should sign its "Primary Market Research Pledge." Getting unbiased market feedback through observations, interviews, and experiments is absolutely crucial to your success.

Do not allow anyone to get too fixed in their opinion early in the process (i.e., stubborn). It is very easy to come to a strong point of view and then start advocating for it too early in the process. If someone appears to be leaning in that direction, the facilitator or someone in the group should openly note it and ask that person to explain the counterarguments to their own proposal, to get them thinking more broadly about both the pros and cons. It is important that people not be driving stakes in the ground with regard to their position, since it will make it emotionally hard for them to change later. You don't have sufficient data at this point to make decisions; you need to do your primary market research.

The best way to tackle the matrix is to assign each market segment to a subgroup within the team—hopefully more than one person so that the resulting analysis benefits from multiple perspectives. Set a deadline to get a first pass done on the matrix. Each team should talk to and/or closely observe a minimum of 10 potential end users from that market segment during the first pass.

After the first pass is complete, have the team come back together and discuss their findings, so that the group can give feedback on each market segment. A few markets may now be eliminated, and the remaining market segments can get even more attention in a second round of primary market research. Do not allow individual personalities or debating skills to dictate which market is chosen, but rather a systematic analysis. Passion does matter, but it needs to be the passion of the group, coupled with a rigorous and realistic analysis.

As we mentioned earlier in this section, it is important that when discussing the first pass results, if anyone seems to be getting too emotionally attached to a market, ask them to argue why the team should not pursue that market. If they still appear to be too attached, swap individuals and allow someone else to continue the research of that market segment.

You will want to iterate multiple times on your matrix, alternating back and forth between primary market research and group discussion of your findings. Getting the matrix as correct as possible will make it easier to achieve forward momentum and save you lots of time later. But institute deadlines for each iteration of the matrix to keep things moving forward at an acceptable pace. Forward progress is essential.

Once you have obtained consensus within the team that you have the best Market Segmentation Matrix you can build in the time frame that is acceptable to your situation, you are ready to move on to the next step in the 24 Steps. Participants should be aware they cannot expect to pull you back to restart this process unless there is truly overwhelming evidence agreed by all that the current market segment selection is not viable. You need to move forward with everyone in agreement. While it is possible that in a later step of the 24 Steps you will get some significant new information that was impossible to know previously, forcing you to revisit the Market Segmentation, in general iterating all the way back to the beginning is the most expensive kind of iteration because all of your work builds off each previous step. Completing the matrix puts your team at a "speak now or forever hold your peace" moment.

Market Segmentation Matrix Row Definitions

1	Market Segment Name	Carefully name the market segment so it appropriately and precisely captures the group you want and no more; it is okay to be general at first, but you will have to narrow this down in time to make real progress.
2	End User	This is the person who is actually using the product, not the economic buyer or the champion (more on this in Step 12)—even if you are selling to a company or a general organization, you want to list here the people in that company who will be using your product.
3	Task	What exactly is it that the end users do that you will significantly affect or allow them to do that they could not do before?
4	Benefit	What is the benefit that you believe the end users will get?
5	Urgency of Need	What is the level of urgency to solve the problem or capture the new opportunity for the end user?
6	Example End Users	Who are examples of end users that you can, have, or will talk to, so as to validate your perceptions of this market segment?
7	Lead Customers	Who are the influential customers (i.e., lighthouse customers) where, if they buy the product, others will take note and likely follow?
9	Willingness to Change	How conservative is this market segment? How open are they to change? Is there something to force change (e.g., impending crisis)?
10	Frequency of Buying	How often do they buy new products? What does their buying cycle look like at a high level?
11	Concentration of Buyers	How many different buyers are there in this market segment? Is it a monopoly? Oligopoly (a small number of buyers)? Or many competitive buyers?
12	Other Relevant Market Considerations	This allows for customization of your segment for relevant considerations such as “high employee turnover;” “very low margins/commodity;” “high-growth industry;” “high virality effect” (i.e., word of mouth), etc.
13	Size of Market (# of End Users)	Estimation of the number of end users to a relevant range (10s, 100s, 1Ks, 10Ks, 100Ks, 1Ms, etc.).
14	Est. Value of End User (\$1, \$10, \$100, \$1K, etc.)	A first-pass estimate of the value of each end user, again to a relevant order of magnitude so you can make some relative decisions now (you will do a deep dive into this and other numbers later).
15	Competition/ Alternatives	What will be your competition from the end users’ perspective? Include the “do nothing” option as well as who else would be competitors if the end users analyzed their options.
16	Other Components Needed for a Full Solution	Since most customers will only buy a full solution and not an individual component that they have to assemble into a full solution, what other elements are needed to construct a full solution to achieve the benefits above? These are the complementary assets that you do not currently have but would need to build or acquire to give the end user a full solution.
17	Important Partners	Who are the partners or distributors you will have to work with to fit into the end user’s workflow (e.g., data must come out of vendor A’s system and then be picked up at the end by vendor B’s system) or business processes (e.g., the end user gets all his or her product via distribution channel C)?
18	Other Relevant Personal Considerations	In many Market Segmentation analyses, there are additional important factors that should be considered. These could be things like where the market segment is geographically centered, whether it matches the values of the founding team, existing knowledge and contacts in market, etc.

Market Segmentation Matrix Starter Template

Market Segment Name									
End User									
Task									
Benefit									
Urgency of Need									
Example End Users									
Lead Customers									
Willingness to Change									
Frequency of Buying									
Concentration of Buyers									
Other Relevant Market Segment Considerations									
Size of Market (# of End Users)									
Est. Value of End User (\$1, \$10, \$100, \$1K, etc.)									
Competition/Alternatives									
Other Components Needed for a Full Solution									
Important Partners									
Other Relevant Personal Considerations									

Team Composition and Dynamics

Before you move on to Step 2, Select a Beachhead Market, consider the team you have assembled. Throughout this step, you should have been keeping an eye on the team composition and dynamics. Be open and honest about how things are working and if everyone should continue with the project. It will be much easier to change team members now than later.

You know it is crucial to iterate on your product to be successful, but your team's composition and cohesion is just as important, if not more important. And yet, people are reluctant to iterate on their team. Don't be like that. You all will pay later if you don't optimize your team now.

I've included the following team table from Step 0. Consider it again, including not just the founders you initially identified, but other participants in the brainstorming process of this step. Which of them may have valuable insights, perspectives, and experiences? If they do not want to join the team, are there others with similar qualities you want to add? Are there members who you do not think would contribute positively to the team?

Name	How Do We Know Each Other?	Knowledge	Skills	Passions/Interests	Founding Team Potential

Make sure you document your decisions so everyone has a clear understanding of how you are going forward, and so team members understand their “ownership” of the business venture. Even if you are not quite ready to incorporate your business, you don’t want a misunderstanding at this early stage to fester and cause trouble for your team later on. Getting legal help may be a wise strategy at this point. The 24 Steps do not cover legal issues related to company formation, such as how to split equity between team members, but Noam Wasserman’s *The Founder’s Dilemmas* is a good initial resource to better understand how to manage team dynamics in a startup.