The Bridgespan Group

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All Customers Are Not Alike

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PREFACE

In a few weeks, everyone reading this document will come together to spend a day with peers, guests, and consultants from The Bridgespan Group, sharing what we've all learned about running "businesses" with paying customers in the nonprofit sector. This short paper is intended to stimulate your thinking by highlighting a few practices we at Bridgespan have found to be helpful as we've worked with clients on their earned-income operations.

INTRODUCTION

Throughout the nonprofit sector, an increasing number of organizations are starting earned-income ventures. These initiatives make it particularly important to recognize one fundamental fact: paying customers are not all alike in their needs or in their willingness to pay.

Customer segmentation is the tool that many businesses use to ensure that they offer the right product to each customer. In the next few pages we will explore the power of using customer segmentation in the nonprofit sector as a platform for thinking about earned income – income for impact – in a more finely granulated way. We'll share how segmentation can inform and shape service offerings and pricing decisions, and suggest some tips to help nonprofits think more audaciously about pricing. The resounding theme: given that all customers are not alike, one service offering and one price seldom fit all.

CUSTOMER SEGMENTATION

WHAT IT IS AND WHY IT MATTERS

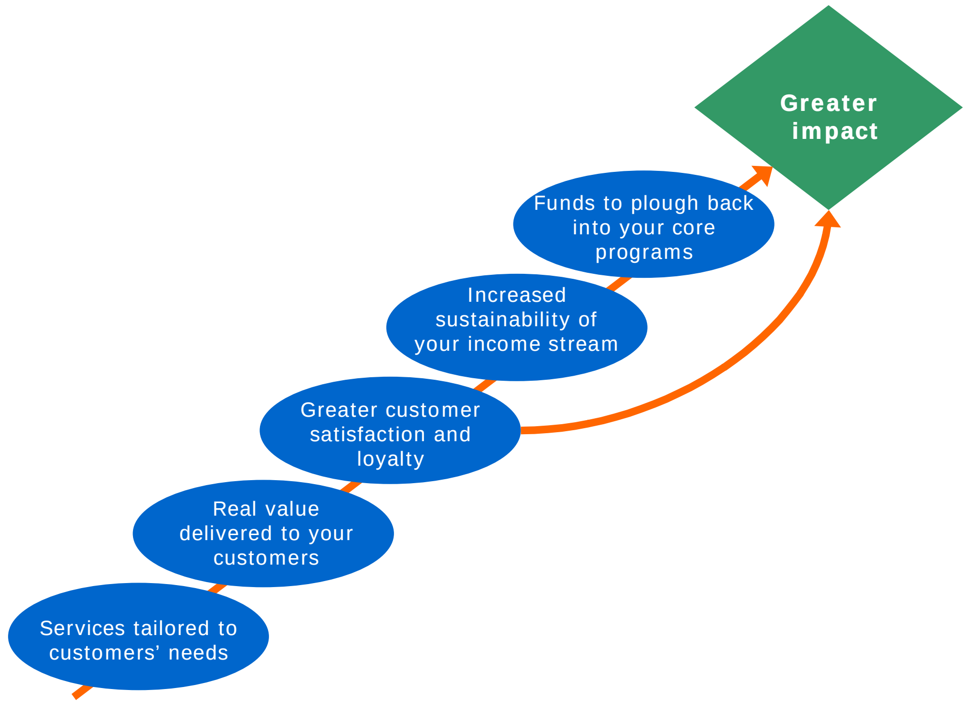
Customer segmentation is another name for grouping customers based on one or more common characteristics. Traditionally, segments are defined by demographics such as gender, zip code, or income. Sometimes they are defined by lifestyle or life stage such as “empty nesters,” “yuppies,” and “soccer moms,” or by specific needs such as hearing-impairment.

In the for-profit world, segmentation is commonplace. Airlines differentiate between frequent business flyers and occasional vacationers. Brokerage firms treat retirees and young couples differently. Auto manufacturers target college kids and suburban families with separate models. The list goes on and on.

Examples in the nonprofit sector also abound. Job training organizations typically serve individuals and corporations in very different ways. Museums tend to offer members special benefits that are not available to the general public. Technology support groups often provide different services to new nonprofits than they do to large established ones.

Segmentation is important not only because it has the potential to increase your organization’s margins, but also because of its impact on mission. Segmentation works because it helps organizations create products and services that their customers truly value. Satisfying customer needs better makes customers more likely to purchase more. If your customers are your beneficiaries, this is direct impact. If your customers are different from your beneficiaries, this provides margin that you can put back into services for your beneficiaries. *(Please see Figure A.)*

Figure A: Increasing impact by tailoring services to customers' needs



PRAGMATIC APPROACHES TO CUSTOMER SEGMENTATION

For many readers, the phrase "customer segmentation" may evoke visions of expensive and complex market research studies. This isn't surprising, given how familiar we all are with classic examples from the for-profit sector: the credit card companies that harvest our credit and spending data; the retail stores that monitor how we shop and what we purchase; the telemarketers that somehow always want to survey us at dinnertime. But it can be daunting for many nonprofits to imagine the intricate analyses for-profit companies must conduct with the data they collect.

Have no fear. What is already known inside your organization can tell you a lot, without multi-month, multi-million dollar research. Tapping into Bridgespan's experience serving clients with earned-income ventures, we can share two examples that illustrate a less formal – and yet quite effective – approach to customer segmentation.

Golden Gate National Parks Conservancy

The Golden Gate National Parks Conservancy (GGNPC) is the nonprofit partner of the National Parks Service in the San Francisco Bay Area. This partnership gives GGNPC the responsibility for funding important projects that the federal government does not support. To produce income for investing in educating children, renovating historic sites, and preserving parklands, GGNPC offers interpretive tours, runs retail shops, and rents space. While GGNPC has been successful at generating earned income over the past two decades, its leadership needed a well-defined plan for substantially raising the level of income they could generate to support planned growth in projects and programs. The missing link turned out to be a process for identifying and evaluating ideas for future growth.

As they identified new income opportunities, GGNPC instinctively focused on two broad categories of visitors: local residents and tourists. While GGNPC management could have taken the time to create more precise sub-segments, they made a great deal of progress simply by recognizing the differing needs of these two segments. Tourists tend to seek informative tours of the parks and unique merchandise as souvenirs. Local users more often look for well-maintained hiking trails or fun, yet educational activities for their kids. These high-level segments allowed this client to develop income plans for various services with the right audience in mind. For example:

- A piece of the Rock: Because Alcatraz is the top tourist attraction in GGNPC's portfolio, creating unique products and services for its visitors can have a huge pay-off. Recognizing that planned demolition and seismic retrofitting would generate huge amounts of debris, GGNPC staff proposed to sell small pieces of rock as souvenirs. Launched this summer, these rocks have been a great new product for Alcatraz. (Another client took a similar tack – and achieved similar results – by selling "Zoo Doo," a fertilizer made from the "doo" of animals at its zoo.)

- Summer camps: Using existing facilities and staff, GGNPC staff launched summer camps in 2002 at Crissy Field, one of their sites. They quickly filled their available spaces. By offering a new service to local residents, GGNPC created a new earned-revenue source while simultaneously fulfilling their desire to educate kids about good park stewardship.

Using what they already knew helped GGNPC introduce two successful new products for two completely different segments and continue to advance their mission at the same time.

VolunteerMatch

VolunteerMatch (VM) provides a second example of the value of taking a pragmatic approach to customer segmentation. VM is a web-based volunteer placement organization whose principal customers are nonprofit organizations looking for help finding volunteers. As with GGNPC, the information that VM staff had came from within their organization – not from a large external research study – but in this case the segmentation got a bit more detailed.

VM management engaged Bridgespan to help them evaluate a range of earned-income opportunities. VM provided volunteer matching services for free, but their management was worried about financial sustainability given that some of their initial grants were unlikely to be renewed in perpetuity. They were looking for a way to continue offering their free core services to everyone, and they thought that earned income for additional or new services might provide part of the answer.

Brainstorming sessions with the management team and staff revealed that there were several new services they could offer for a fee, but they were unsure about which ones to prioritize. To answer this question they needed to know more about their customers.

An internal group of VM staff believed that rather than focusing on the "demographics" of nonprofits (such as "large national" or "youth service provider"), the specific needs of distinct sets of nonprofits should drive their segmentation. These needs, they suspected, would dictate which services a nonprofit might consider paying a small fee to use. VM characterized their existing nonprofit customers according to the life stage and technological sophistication of their organizations, identifying four groups: Strugglers, Techies, Administrators and Self-Improvers.

Segment	Buyer characteristics
Strugglers	EDs or other key executives of under-staffed organizations who are continuously looking for more volunteers
Techies	Volunteer coordinators who want to use technology to help them manage their volunteers
Administrators	Coordinators of national or regional nonprofits who would like to make sure the volunteer programs at affiliates are on track
Self-Improvers	Volunteer coordinators who are eager to improve their volunteer programs

It is important to note that although this segmentation process recognized the needs of all VM customer groups, the purpose was not to help the organization create products or services for all segments. Just as in the for-profit world, trying to be all things to all customers is counterproductive. Rather, the purpose of the segmentation exercise was to help VM identify those segments they could serve most effectively.

In fact, this segmentation process helped VM determine that they could not effectively help the "Strugglers." On the other hand, a deeper understanding of the "Administrators" led VM to create a service that allows nonprofits to post volunteer opportunities in multiple zip codes. Similarly, knowledge of the "Tech Savvy" customers' needs prompted a new service that sends automatic email confirmations to interested volunteers.

Segmenting VM's customers was not a trivial exercise. It took hours of internal meetings to create the segments as well as to match new services to their needs. A key turning point came when the group started to give the segments names, as doing so allowed the discussion to progress to a deeper level and the segmentation became more refined.

As the GGNPC and VM examples begin to illustrate, needs-based customer segmentation can help nonprofits make sensible decisions about product design, sales, marketing, distribution, and customer service. In fact, segmentation can be the crucial first step in ensuring that an earned-income idea has value to some set of customers. But getting the service offering right is only the first part of the story. If a service has value, that's great, but will the customer pay for it? If so, how much?

PRICING

CHARGING NEITHER TOO MUCH NOR TOO LITTLE

Once you know your customers and the services you want to offer your various customer segments, how should you think about price? Finding the right price is critical. Charge too much, you shut out potential customers or disrupt your mission. Charge too little, you leave money on the table that could advance your mission.

In Bridgespan's experience, nonprofits are (at least initially) more likely to under-price their services than to overprice them. There is a sense that because the organization is focused on helping people, the socially responsible thing to do is to keep the price as low as possible. That is not always true. In trying to serve more people with a lower price, organizations may be missing the opportunity to do more good overall (e.g., serve more people) by charging a higher price.

Also, think about your own reaction to low prices. When presented with a low price, do you always assume great value, or do you sometimes become suspicious about the quality of what you are being offered? Consider this example from a recent Bridgespan client that, like many museums, zoos, and aquaria, operates a store on its premises. This store sells a baseball cap with the organization's logo for $8.95, a small mark-up over the cap's cost. Interestingly, the cap is not a big seller even though caps are, in general, a popular souvenir at similar shops across the U.S. One hypothesis is that the cap is priced too low; at $8.95, shoppers may view the cap's quality as suspect rather than thinking it's a bargain.

Customer segmentation provides a springboard for two pricing strategies that allow you to charge each customer the appropriate price: (1) Charging different segments different prices for the same service and (2) Offering enhanced services for customers willing and able to pay more.

Charging different prices for the same service

In some cases customer segments translate naturally into pricing tiers, with each segment being charged a different price for the same service, frequently based on ability to pay. Take the example of schools and colleges. Nonprofit schools and colleges are some of the best models of tiered pricing because of financial aid. By charging a high tuition, but subsidizing it for those who cannot pay full freight, schools can create the maximum income that the market will bear while fulfilling their mission to be open to a broader, more diverse pool of applicants.

Enabling some people to receive services free or at a discount is often an important goal. For example, a job training organization that offers some clients grants, aid, or discounts supports its mission in two ways: financially, thanks to those who pay the full rate, and philosophically, by not turning someone away simply because they cannot pay.

The same logic applies to zoos and aquaria that do not charge school groups to visit. That decision is completely consistent with their mission to connect kids with nature, but by charging other visitors full price, they also sensibly generate revenue to support their mission and keep the gates open for everyone.

Charging more for more service

For many nonprofits, the essential services they provide are intended to be free. It is part of the very fabric of the organization. Recently, however, we have begun to see more cases in which the nonprofit offers its original service for free, but creates an enhanced or upgraded version that has additional benefits, may cost more to deliver, but can be priced at some level greater than free.

Keeping a basic service free and charging others more to get more is a technique several nonprofits have used successfully. This is the route VolunteerMatch pursued. VM had a longstanding internal policy that their network was open to all nonprofits and all potential volunteers without fee. As VM looked for sources of earned income, they identified additional services or features for which some nonprofits (at least one segment, that is) would be willing, and even eager, to pay a fee. For those who wanted standard listings and very little else, the price remained zero. In 2002, VM created a premium service called the Community Leaders Program, offering additional services for an annual fee for those who sought more extensive listings, or email notifications. As the segmentation exercise predicted, nonprofits that VM would classify as "administrators" have been ones signing up.

Philanthropic Research, Inc. with its Guidestar online database provides another example. With the mission of "revolutionizing philanthropy and nonprofit practice with information," Guidestar gathers and distributes data on more than 850,000 IRS-recognized nonprofits. Guidestar initially provided all services for free, but after a few years set out to generate revenue internally to supplement grant funding. Above and beyond their basic free service, they began marketing various services including: reporting on an organization's finances over time; allowing grantmakers to verify tax-exempt status; and providing nonprofit executive compensation information. More recently, Guidestar has added a new feature that lets website visitors analyze multiple charities by creating custom spreadsheets. All Guidestar customers can still get the basic information and Forms 990 for free, but those with more advanced research needs (and a higher willingness and ability to pay) are now able to access more in-depth data for a fee.

In considering both charging different prices for the same service and charging more for more service, there is a temptation to think that these pricing approaches are only appropriate for a narrow set of nonprofits. In fact, any organization that offers education, training, information, or even direct service could serve itself well by looking for a "paying" segment in their area that could help subsidize the core non-paying beneficiary. That new segment might help generate more revenue from the same service they already offer (e.g. corporations paying for their employees to take English language classes that are free to individual non-English-speaking clients) or from customers paying more to get more (e.g. GGNPC charging more for a limited-capacity, special nighttime tour of Alcatraz than they do for the daytime tour).

ESTABLISHING SPECIFIC PRICING LEVELS

With these two techniques at hand for differentially charging your various customer segments, how do you zero in on the exact pricing levels? Possible approaches include cost-based pricing, market pricing, testing, and one-off pricing.

Cost-based pricing

Organizations frequently use “cost-based pricing.” This approach is sensible if you ensure that you cover your costs and overhead, but does not take into account the possibility that customers may be willing and able to pay much more than the minimum you need to hit an internal cost hurdle. Since customers may be willing to pay more than it costs to deliver a service, cost-based pricing should be used to create the price floor (the minimum price you would set), but not the price charged.

One problem facing many nonprofits that price to cover their costs is that they do not calculate the true full cost of the activity and therefore charge a price that does not create a positive margin to reinvest in their mission. Not covering the cost of a particular program is not a problem per se; it may be a program that is central to the organization’s mission. In fact, running a nonprofit often involves activities that do not cover their full costs. But many nonprofits have programs or ventures that are intended, at least, to cover their costs but do not actually do so. (For a more in-depth description of full costs, we invite you to refer to the article “Costs Are Cool” on The Bridgespan Group’s website.)

Market pricing

“Market pricing” addresses the pricing issue by looking at what others charge. You set your price by looking to see what people are paying for a similar product or service out in the world today. This works well in many cases. For example, if you were trying to decide how much to charge for a summer camp at a national park or a zoo, you would naturally look at what other camps charge. You would find lots of examples of the prevailing prices for summer camps in your area. This sort of benchmarking is valuable and usually worthwhile.

Testing

Unfortunately, market pricing won't get you very far if you are creating a whole new category. The for-profit world is filled with examples of people creating new categories. Starbucks never would have created a $3 cup of coffee by market pricing. Nor would American Express have charged $250 for the first Platinum cards by benchmarking competitors. These are two fantastically successful products and companies, but neither could have gotten off the ground without managers who were willing to test what some potential customers might pay.

Testing is frequently overlooked in both for-profits and nonprofits. Trying to determine if a new product or service will be popular enough to succeed is hard work. Often, a new idea is simply rolled out and either succeeds or bombs. For example, years ago, after much success delivering packages, FedEx offered to send, receive and deliver faxes. No one was willing to pay FedEx to send faxes for them, however, and so the product called ZapMail failed.

An added twist in testing is that price is a very hard variable to research simply by asking people what they will pay. Some form of live testing (or even a technique called dry testing that simulates a real sales call) can be used to determine what people will actually do in a real-life purchasing situation. Trying a price for just a few customers at first, testing in just one region or geography, and even on-line testing for just a limited time are ways to get real results without conducting a full-scale rollout.

One-off Pricing

Having discussed cost-based pricing, market pricing, and testing when you have a whole new idea, there is one final (and very special) case in which you should think about setting a high price. We call this "one-off pricing."

In most cases pricing has to be appropriate to satisfy a large number of customers, usually over a long period of time. One-off pricing occurs when you have (and need) only one customer because you have only one item to sell. Your home is a great example. When you are ready to sell your house you don't want the approximate amount that many people would pay. You want to get the amount that a single eager buyer would pay.

For nonprofits, one-off opportunities exist in several forms. Perhaps you run a community service program or hold a fundraising event that a local corporation might sponsor. You can set the price of that sponsorship at whatever the most interested corporation will pay. Making the sponsorship attractive to that corporation is essential, but this situation is a case of having a "segment of one."

Maybe you own some physical assets, or even a building. Selling these assets would be one-off situations. Clearly, some situations can occur more than once, so we all want to ensure that we don't build a reputation as unreasonably high priced. But when these one-off situations arise, it is wise not to be timid in setting price.

CONCLUSION

As soon as an organization starts to charge for something, the demanding work of managing a nonprofit becomes even more complex. The opportunities that come from running an earned-income venture are great, but so are the challenges of doing it well. When you have more than one customer, there may be more than one set of needs to understand and to satisfy and there may be an opportunity to price more effectively.

From customer segmentation to pricing alternatives, we have touched on a number of ways nonprofits are using techniques commonly found in the for-profit sector but applying them to the inspiring task of increasing their income to create more social impact. Clearly many nonprofits – including your own – already do a lot of the things we've discussed, but perhaps we have shared a new idea (or a provocative example) that has inspired you to share a new thought with your staff or put something new into practice in your organization. At the very least, we hope we have stimulated how you think about your customers and your pricing, and that one or more of these thoughts will influence an existing product or service or make the launch of a new venture more effective.

We look forward to hearing your thoughts and incorporating your own experiences at The Bridgespan Group Executive Working Session on Impact and Income.

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