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Strategy

Difficult Markets Demand Volatility as First Segmentation

Donald Potter

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In tough markets, new sales are scarce. Use this tool to focus efforts on volatile segments.

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No company is likely to thrive in a challenging market without a deep understanding of market Volatility, the dynamics of shifting market share among suppliers. As markets mature, Volatility typically decreases, reaching extremely low levels in Hostile, overcapacity environments. Over time, many industries gravitate toward such hostility, especially as growth slows and competition intensifies. In these conditions, a significant portion of both current and prospective customers may prove unprofitable.

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Donald V. Potter, "**Customer Buying Hierarchy: Simple Criteria for Deep Market Insight**." California Management Review Insight, (May 2025).

Through our experience navigating these markets, we have developed expertise in leveraging Volatility to advantage. This led to the creation of the Supplier/Role Matrix, a tool that segments and displays market Volatility, enabling companies to answer four critical questions that drive improved performance in tough market conditions:

- How large is our current/potential relationship with the customer (hereinafter Buyer)?
- Would the Buyer purchase (or buy more) from us?
- Would the Buyer relationship be profitable?
- Under what conditions would you serve the Buyer?

These are complicated questions to answer. This article describes an approach to this segmentation, reflecting experience from 30 years working in Hostile and near Hostile markets. We have developed shortcuts to use the approach efficiently.

The approach works in most markets (e.g., Supplier to Final Buyer, Supplier to Channel, or Channel to Final). For this article, we will use a market where the Supplier sells to Final Buyers through Channels of distribution Buyers. We will use five real examples from this type of market to illustrate our approach.

The article leads you through three essential analyses to segment and exploit Volatility:

1. **Supplier/Role Matrix:** Uncover the underlying segment structure of the market.
2. **Volatility Analysis:** Use the Size/Role Matrix to identify the magnitude and causes of Volatility, and opportunities it presents.
3. **Buyer Segmentation and Prioritization:** Leverage the Size/Role Matrix to establish strategic priorities for every Buyer.

Reveal Supplier/Role Segments

We developed the Supplier/Role Matrix tool to visualize practical segments. This tool identifies groups of Buyers with similar Size and importance, defines the Roles available with these Buyers and quantifies the market segment structure.

Buyer Sizes

Bigger is usually better but grouping Buyers by Size can be complex. To streamline this process, try the following shortcuts:

- **Focus on the market's standard, (most common), product.** Collect a representative sample of current Buyers and their purchases of the standard product over the last three years. Ignore the other products for the time being. This standard product sets the market baseline for industry performance and price. It often commands more than 60% of the market's unit sales.

- **Use unit sales**. Units drive economies of scale and overall returns.
- **Force initial size segments.** Group Buyers into broad categories of Buyers with roughly equal attractiveness. Rank all Buyers in the sample by the size of their standard product purchases. Then, apply a modified version of the Pareto Principle to define an initial segmentation.
    - Make the first Size break at the purchase volume of the lowest Buyer in the category purchasing the top 50% of the total units purchased in the sample.
    - Repeat the procedure to determine cutoffs for the top 80% and 95% of unit purchases.

This process yields a set of rough Size groupings, as illustrated below.

Illustrative Typical Market

Buyer Size	% Mkt Volume (% Standard Unit Sales)	% No. Buyers
Very Large	50	7
Large	30	13
Medium	15	25
Small	5	55

- **Adjust for importance**. Fine tune these categories so each grouping reflects Buyers of roughly equivalent importance. You may use more categories if you wish. Note that the “average” Buyer is a Small Buyer, less relevant for your segmentation. Instead, focus on the Very Large and Large Buyers.

Roles And Reasons

Large channel Buyers typically offer a Supplier one of three Roles in their relationships:

- **Primary Role.** Lead Supplier, receiving a sizable portion, often 50% or more, of the Buyer's purchases. The Buyer relies on this Supplier for product features, for reliability in the relationship and product, for purchase convenience and competitive pricing.
- **Secondary Role.** Receiving the second most volume of purchases. This Role serves purposes, such as:
  - Backup supply in case of Primary Supplier delays
  - Price benchmarking to ensure the Primary Supplier remains competitive.
  - Service leverage to induce good service from the Primary Supplier.
- **Tertiary Role.** Receiving the third most volume providing benefits such as:
  - Price leverage to negotiate a lower price from its other Suppliers.
  - Service leverage,
  - Specialized products unavailable from Primary or Secondary Suppliers.

The Tertiary Role segment may offer limited opportunities to transition into better Roles.

If Buyers offer Roles below these three, these lower Role Suppliers offer benefits like those of a Tertiary Supplier.

If a market offers more than four Roles, it may indicate geographic segmentation opportunities. In that case, consider a business segmentation for each distinct geographic region.

Supplier/Role Matrix

The Matrix visualizes the market's strategic segments by quantifying how Buyer Size segments allocate their purchases to the Supplier Roles. This analysis reveals your current market strategy and that of any competitor.

You simplify this analysis by enlarging your data sample on the Very Large and Large Buyer segments. A modest sample of the Medium and Small Buyers should provide reasonable estimates of their purchase allocations. A Supplier who succeeds with the

larger Buyers, will attract sufficient Medium and Small Buyer purchases to assure success in those markets as well.

The resulting Supplier/Role Matrix might resemble the following:

ILLUSTRATIVE REAL MARKET BUYER SIZE/ROLE MATRIX

(% TOTAL MARKET UNIT VOLUME)

Customer Size	Primary Role	Secondary Role	Tertiary Role	Total
Very Large	40	6	2	48
Large	25	5	2	32
Medium	13	1	NA	14
Small	5	1	NA	6
Total	83	13	4	100

A Hostile market usually sees shares consolidating in the Primary and Secondary Role segments with the Very Large and the Large Buyers. These four segments make up the heart of the market, where any aspiring market leader must excel.

You may check your (or any competitor's) strategic strength on the Matrix by using an index on sales. Divide your sales percentage in each Role segment on the Matrix by the market's percentage. An index above one indicates strength, while an index below one indicates relative weakness. The indices for the Primary Role segments with larger Buyers are particularly important.

Here is an example of the Supplier/Role Matrix of a Supplier in a Hostile market:

COMPANY VOLUME INDEX
(100: % Units by Position=Market)

	Primary	Secondary	Tertiary	Total
Very Large	44	0	150	59
Large	184	66	50	156
Medium	36	50	0	38
Small	133	0	0	100
Total	111	39	118	

This example illustrates a Supplier focusing on Primary Roles with Large and Small Buyers. Its limited success with Very Large Buyers suggests a weak Supplier.

Identify Volatility, Its Causes and Opportunities

Volatility is market share in motion, both positive with share growth and negative with falling share. Volatility has specific causes which change as the market evolves. At any evolutionary stage, Volatility highlights opportunities for share gain. The Supplier/Role Matrix unveils the Volatility opportunities.

Positive And Negative Volatility

A change in your market share may have two components, growth of your Buyers and net Volatility. Any share changes due to your Buyers' own change in share in their markets reflect your past decisions on Buyers to pursue. Net Volatility is the more critical

evaluation factor, revealing the success of your current marketing and sales strategy.

There are both positive and negative forms of Volatility. Positive Volatility includes unit sales to Buyers entering or increasing relationships with the Supplier. Negative Volatility includes unit sales of Buyers leaving or decreasing their relationships with the Supplier. The percentage of Volatile Buyers is generally higher than the percentage of Volatile unit volume. Most Buyers in Hostile markets are reluctant to make wholesale changes in their relationships.

Net Volatility is the difference between positive and negative Volatility. The market's positive and negative Volatility is the sum of the individual Volatility results of the market's Supplier group. Each Supplier in the market will also have its individual net Volatility, where you focus your attention.

Your net Volatility projects your likely future market share performance. Positive net positive Volatility promises growth. The opposite holds for net negative Volatility.

Volatility With Market Evolution

The magnitude of total market positive Volatility decreases as the market matures due to narrowing benefit and price differences among Suppliers. A young, fast-growing market might have positive Volatility levels of 15% or more of the total market's unit sales. A typical mature market might see positive Volatility levels of 10% of unit sales. A slow growing, sometimes Hostile, market would see low Volatility levels, around 4% or less.

These positive Volatility levels reflect the types of market innovations that dominate the tactics of the market's successful Suppliers. New function and price innovations by Suppliers characterize a fast-growing market. These innovations usually have high value for both existing Buyers and new entrants. These innovations enable the innovating Suppliers to win market share with positive Volatility.

Gradually, competing Suppliers copy the successes of unique functions and pricing approaches. Additional function innovations appear less valuable to Buyers and market pricing variations stabilize as the market matures. Then, Supplier initiatives in quality,

reliability and convenience of purchase lead Supplier innovations and positive Volatility in the market. These innovations have lower marginal value for the market's Buyers, leading to a decline in positive Volatility and a smaller proportion of Volatility based on Supplier competitive wins against competition.

Finally, as the market becomes saturated, and potentially develops Hostility, market positive Volatility becomes quite low. Supplier innovations in this evolutionary stage of the market are minor and far less important to Buyers who, in turn, often opt to remain with their established Supplier relationships. Trust and convenience of purchase from known Suppliers dominate the Buyers' hierarchy of needs. Positive Volatility reaches a low level.

At this last stage of market evolution, negative Volatility drives market opportunities through the failure of incumbent Suppliers. A Buyer changes Suppliers only after a failure of one of its Suppliers, which occurs when that Supplier will not, or cannot, offer a Buyer a benefit or price that half the other Suppliers in the market can or will offer.

By the time the market becomes slow-growing, or even Hostile, an incumbent Supplier failure likely precedes 75% or more of the market's positive Volatility. An incumbent Supplier must fail its Buyer on a benefit before the Buyer opens its relationship to another Supplier. This failure, and the negative Volatility it elicits, open positive Volatility opportunities for other Suppliers.

Volatility On The Size/Role Matrix

The total market exhibits net positive or negative Volatility at each segment of the Supplier/Role Matrix. An illustration of Volatility by segment appears in the exhibit below.

SHARE SHIFT BY SIZE AND ROLE
(% Units)

	Primary	Secondary	Tertiary	Other
Very Large	+3	-1	+1	-3
Large	+2	0	-1	-1
Medium	+1	0	0	-1
Small	0	0	0	0
Total	+6	-1	0	-5

This market is consolidating purchases in the Primary Roles with Very Large and Large Buyers as the outlying Roles cede share.

Each Supplier in the market also exhibits individual Volatilities on its Supplier/Role Matrix. The example below illustrates one Supplier's positive Volatility.

POSITIVE VOLATILITY INDEX

(Index: 100% Volatile Units by Position=% Market Volatile Units)

	Primary	Secondary	Tertiary	Other	Total
Very Large	122	209	55	58	118
Large	58	52	NA	NA	56
Medium	114	123	263	80	122
Small	79	59	NA	63	77
Total	98	154	74	59	

This Supplier is winning share with the Very Large and Medium Buyers while declining with Large and Small Buyers. The Matrix suggests that this Supplier is especially strong in Secondary Role segments.

In a slow-growing and Hostile market, a Supplier is not likely to get into or improve its relationship with a Buyer unless the incumbent Supplier in that relationship fails. Since the Primary and Secondary Supplier to Very Large and Large Buyers are commonly peers of one another, a challenging outside Supplier will often find it difficult to enter a Primary relationship with these Buyers unless both incumbent Suppliers fail.

Importantly, successful leaders in Hostile markets often gain more share in the market by losing less rather than by winning more. These leaders exhibit lower negative Volatility than the average Supplier even if their positive Volatility is not exceptionally high. Preventing share loss with crucial Buyers is paramount in failure-driven markets. All slow-growing markets are failure-driven.

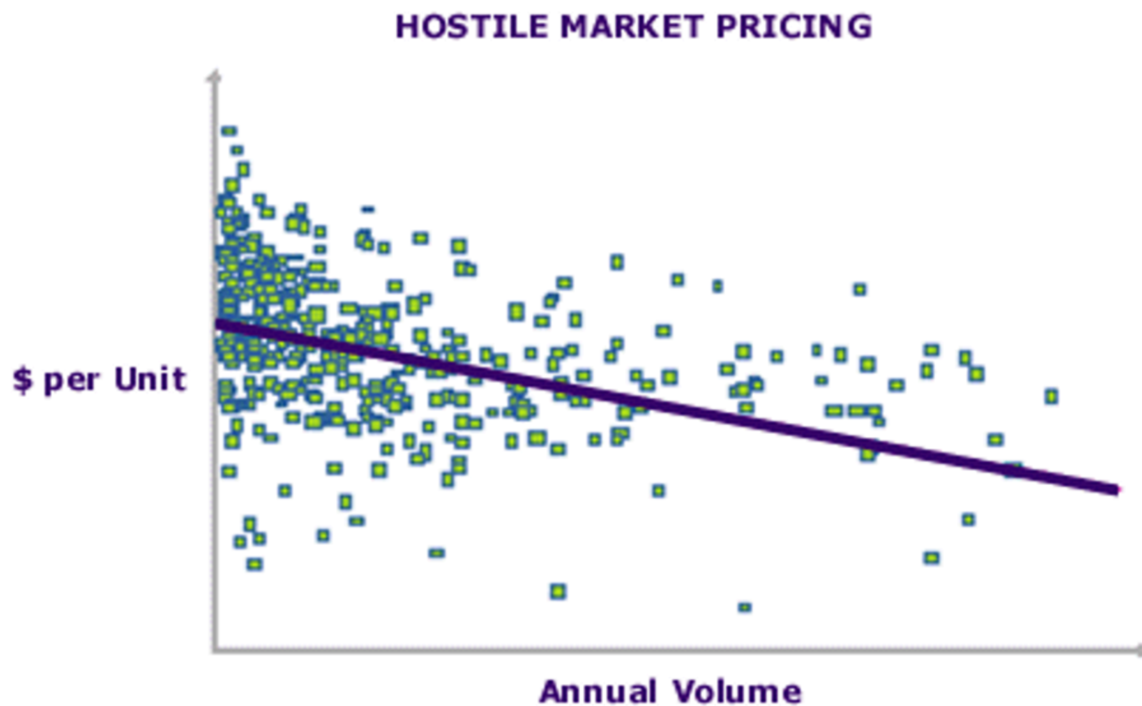
Segment Buyers and Reset Priorities

The Supplier/Role Matrix identifies market Volatility and segments Buyers to optimize your marketing strategy. The Matrix categorizes Buyers based on profitability and allows you to set clear marketing priorities. Pricing plays a pivotal role in determining the returns from Buyer relationships, making it an essential first consideration in identifying attractive Buyers.

Pricing In Hostile Markets

Pricing in a Hostile marketplace is chaotic compared to a less intensely competitive, normal, market. A normal market will often see market pricing discipline where unit price falls predictably depending on the Size of the Buyer's purchases. This discipline is nonexistent in a Hostile marketplace. On average, Hostile market prices do decline with the increasing Size of a Buyer. However, virtually every Buyer negotiates a unique price. These prices, and resulting profit margins, often vary widely both within any Buyer Size segment as well as across Size segments.

Here is an example of price dispersion in a Hostile market:



You use the pricing of your current Buyers to project their future relative prices. Our research into Hostile markets has indicated that over two thirds of Buyers will maintain their level of pricing relative to their peers over a three-year period.

For prospective Buyers you estimate their expected prices from a regression line "forecasting" price by Buyer Size segment based on known current market prices. The dark line in the graph above is a regression line "forecast." You adjust this "forecast" according to expectations for anticipated Buyer price changes.

Segments Of Core and Other Buyers

Buyers fall into three return groups based on expected returns through a business cycle:

- **Core Buyers** have pricing and cost profiles that allow you to earn at least your cost of capital through the business cycle. The margins might be low during times of Hostility but then recover in better times through the cycle.

- **Near Core Buyers** earn you a positive return on capital in your relationship, but a return below your cost of capital.
- **Non-Core Buyers** generate positive cash flow but a negative return on net capital employed.

You make assignments to a Core category for each of your current Buyers. For prospective Buyers, you apply price and sales averages for each segment on the Size/Role Matrix to project a base case Core category for a typical Buyer in each segment. You adjust sales volume to reflect likely Volatility with the Buyer.

You use these projections for prices and your costs for each segment on the Supplier/Role Matrix to set minimum criteria for Core and Near- Core Buyers. Each segment on the Size/Role Matrix then breaks into three further segments based on these minimum criteria. Because of the very wide dispersion of prices among Buyers of various Sizes, you are likely to find potential Core Buyers in each segment on the Supplier/Role Matrix.

Strategic Priorities For Segments

These Core category segments and their characteristics on the Supplier/Role Matrix guide strategic priorities:

1. **Stabilize Core Buyer Relationships.**

   Reduce negative Volatility with your current Core Buyer segments. These are the segments with the lowest cost to increase share. Reduce your failures with these Buyers.

2. **Capitalize On Limited Positive Volatility Opportunities.**

   Strengthen your ability to win positive Volatility opportunities. Missing these opportunities is equivalent to a failure. These failures occur when other Suppliers defeat you in an evaluation runoff or when a Buyer does not invite you to propose on

a potential new opportunity. The reasons for the failures on these two occasions may differ from one another. You will want to address both failures because they represent Buyer needs where others currently surpass you.

3. **Redirect Resource Allocations.**

   In Hostility, concentrate resources on Core segments while employing Near-Core and Non-Core relationships opportunistically. In a market with substantial overcapacity, all your chosen Buyer segments should produce a cash contribution. You would create new or build on relationships with any Core Buyer. You would serve Near and Non-Core Buyers primarily for your benefit, using your excess capacity or the capacity you have reserved to serve Core Buyers. You would prefer to serve Near Core Buyers over Non-Core Buyers. During periods of overcapacity, your efforts focus on moving Near Core and Non-Core Buyers into a better segment.

   Your focus on Core Buyer segments sharpens as the market begins to recover from Hostility and absorbs its excess capacity. You would gradually withdraw from Non-Core Buyer relationships which cannot support additional capital investment. Similarly, you would reduce your relationships with Near Core Buyers as you need more of your total capacity for Core Buyers. Further, you would delay bringing new capacity to the market until your Core segments are certain to need it.

To summarize, return to our opening questions, using the market's Volatility shown by its Supplier/Role Matrix as a strategic segmentation tool to respond:

- How large is the relationship with the Buyer?

  The combination of the segment's purchase volume for the Size of the Buyer and the Role it assigns to you.

- When would the Buyer change Suppliers?

  The Buyer Volatility is a characteristic of its Size /Role segment and the relative strength of your benefits to enable a win or to avoid a failure.

- Would the Buyer relationship be profitable?

The expected price for the Buyer/Segment's average purchases less expected costs forecasts base profitability.

- Under what conditions would you serve a Buyer?

  Pursue and serve Core customers in all market conditions and other customers opportunistically. Set minimum criteria for inclusion of any buyer into the Core category.

This Size/Role Matrix segmentation of market Volatility raises margins by improving your Buyer mix and your ability to meet Buyer needs currently met better by your competition. This process of segmenting Buyers according to Volatility and your needs sets the stage for the more traditional segmentation focusing primarily on evolving Core Buyer needs.

Donald Potter Follow

Don Potter is a consultant to senior managements of substantial companies. He was a partner at McKinsey & Company for several years and then headed his own firms, Windermere Associates and StrategyStreet. Don's current work focuses on presenting and explaining the concepts behind StrategyStreet.