Market share is not enough: why strategic market positioning works

Stuart Jackson

Introduction

The ultimate task of senior corporate decision makers is to create value for the company’s shareholders.

Research conducted by my firm, LEK Consulting, combined with experience gained from hundreds of client engagements, suggests that one of the most effective ways to create value is to understand and build what we call “strategic market position,” or SMP. For a business or product line that competes in only one strategic segment, SMP is simply the market share of the business in its strategic market segment. For a company competing in multiple strategic segments, its overall SMP is the average of its SMPs in each strategic segment, weighted by the business’s sales or investment in each strategic segment.

Achieving effective SMP involves analyzing an industry to determine strategic market segments and then making investments in those segments that will lead to increased returns – in other words, putting corporate assets where they are likely to be most productive and minimizing their use in less productive sectors.

Unequal performance

A LEK Consulting/Wall Street Journal study of shareholder value for 1,000 leading US public companies during a recent five-year period revealed that in almost every sector, the top-performing company was not 5 or 10 percent better than the worst performer; but 200, 300, sometimes even 1,000 percent better (The Wall Street Journal, 2005).

Consider an aggregate summary of this finding, with an eye toward the return on a $1,000 investment made in 1999.

As Figure 1 illustrates, performance within an industry sector varies enormously. To cite one of the more dramatic examples, a $1,000 investment in specialty retailer CarMax in 1999 would have been worth more than $13,000 five years later; the same $1,000 investment in Circuit City would have been “below water” after the same five years.

One should bear in mind that these are “top 1,000” companies, run by some of the USA’s most experienced and skilled managers. What explains these huge differences in performance within a given sector? A major part of the difference comes from companies’ respective choices about where and how to grow. The more successful companies understand the importance of correctly assessing and achieving increased scale and market share and how they can build their competitive strength and thereby increase shareholder returns. In short, they achieve effective SMP.

SMP and market segmentation are not the same thing

The most common version of “market positioning” is the familiar process of market segmentation. This is a marketing technique that involves breaking down a market into
smaller segments in order to better understand consumer behavior and identify opportunities to increase overall market share. SMP is different because it brings together the disciplines of strategy and finance to help shape a company’s approach to value creation.

Organizations that fail to differentiate between market segmentation and SMP may be at risk because the definition of market share often does not correlate with company profitability, returns, and strategic potential. The SMP definition of market share, however, is strongly correlated with financial performance and value creation.

It is therefore critical to develop an appropriate definition of “market share” when applying SMP – a definition that captures the real drivers determining the economics of a particular industry or business. This may sound elementary, but in our experience it is not that simple. Does market share mean share of product, share of category, share of channel, share of customer, share of region, or share of something else? Companies that cannot answer this question cannot effectively engage in SMP and in the long term will find it difficult to invest successfully for growth.

In addition to defining market share precisely and accurately, it is critical to understand the impact of different approaches to growing market share. Traditional strategic thinking would argue that bigger is better – that increased overall market share is better almost regardless of what the company has to do to achieve it. Our research and experience show, however, that this is not always the most effective approach. For example, a reasonably large player in a given industry may earn an average 7 percent return on $300 million in sales. A significantly smaller player, by contrast, may perform far better, earning, say, a 14 percent return on $150 million in sales. In other words, the company that is half as big makes twice as much on a percentage basis.

There are several possible explanations for this difference. The smaller, more profitable company may avoid going head-to-head with larger, more powerful competitors. It may deploy its investments into segments where, among other things, the dominant players simply do not compete. In essence, it positions itself in its industry strategically and allocates more assets in fewer, carefully selected ways. As a result, it has a much higher market share in its chosen segments.
A three-step action plan

SMP can be summarized in the following three-step action plan. Although plans will vary depending on a company's specific circumstances, a typical plan would include these three major activities:

1. **Be creative and cast a broad net.** To maximize the chances of identifying successful strategies, think beyond the current business offerings. Evaluate other businesses that share the same customers or leverage the same technologies. Consider service as well as product offerings. Identify the range of organic or acquisition initiatives that could be used to pursue potential growth strategies.

2. **Apply the SMP test.** Identify the growth strategies that have the greatest potential to increase the company’s weighted average relative market share, as measured across all strategic segments impacted by the strategy. This will identify strategies that have the potential to improve the company's overall position on the most important drivers of profitability. Apply the SMP test quantitatively to specific initiatives to see whether market share, appropriately defined, increases or decreases.

3. **Apply the value-creation test.** “Strategic value” is defined as the net present value of cash flows from higher revenues, lower costs, and lower capital requirements that will accrue from the growth opportunity and the existing business being run together versus separately. If the strategic segmentation and value creation tests have both been performed correctly, the most attractive options should come out on top using both methods. To explain in greater detail how SMP works, let’s consider examples of competitors in two widely different sectors: the airline and the health club industries.

**Southwest and America West**

Southwest Airlines and America West Airlines started in comparable positions but ended in very different places. Both started as low-cost, low-fare regional carriers. Although Southwest's first flight took off 12 years before that of America West's first flight (www.southwest.com), both airlines grew their operations and profits on roughly parallel tracks through the early 1990s[1].

America West followed a traditional hub-and-spoke design for its flights and became well known for its expansionist strategy. Southwest, on the other hand, grew at a slower pace, taking the time to build up strong positions in specific markets before penetrating additional markets. Southwest’s emerging strategy was creative and focused on short-haul, high frequency flights in city pairs where the airline could secure a strong market share position, often flying to a secondary, lower-cost airport. In addition, its costs were controlled as a result of the decision to use (and therefore maintain) only one type of aircraft, the Boeing 737 (Thunderbird, The Garvin School of International Management, from Department of Transportation, 2005).

By contrast, America West's expansionist strategy called for international routes, which in turn called for a heterogeneous and expensive-to-maintain fleet. Table I summarizes the two airlines’ positions and strategies in 1990.

America West did not base its strategy on the core tenet of SMP, which is to build the type of market share that maximizes high-impact growth and leverages economies to the greatest extent possible. Figure 2 compares the two airlines in terms of traditional market share and SMP to reveal the true impact of their different strategies.

Consider overall market share. This is the measure most often regarded as relevant. Unfortunately, it is not a terribly helpful measure when analyzing and developing growth strategies. Although America West and Southwest had similar US total market shares in 1990, this measure obscures their relative competitive strengths.

In the airline business, pricing power and operating costs are driven more by share of flights between states or, more precisely, by share of flights between specific city pairs. Travelers prefer to fly an airline that has several daily flights between two points because it gives them
more flexibility in the event of a missed or delayed flight. This is better for airlines because they are likely to have larger scale and more efficient operations at each end.

Southwest Airlines recognized this as a critical factor and was careful to enter a new market only when it felt it could achieve substantial strategic share in that market. By contrast, America West assumed that by entering larger and increasingly international markets, it was strengthening its overall position in the airline market. In fact, it was neglecting its core franchise and spending limited resources to enter new market segments where it had little to offer against strong competitors.

The financial outcomes that resulted, in part from these very different strategies, are striking, as Figure 3 illustrates.

Since America West’s emergence from Chapter 11 in 1994, its stock has declined at a CAGR of −4.9 percent, while Southwest’s stock has grown at a CAGR of 9.9 percent[1]. To be

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**Table 1**

<table>
<thead>
<tr>
<th>Summary statistics (1990)</th>
<th>Southwest</th>
<th>America West</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue ($ millions)</td>
<td>1,186</td>
<td>1,315</td>
</tr>
<tr>
<td>Number of aircraft</td>
<td>106</td>
<td>104</td>
</tr>
<tr>
<td>Types of aircraft</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Flight design</td>
<td>Point-to-point short haul</td>
<td>Hub and spoke</td>
</tr>
</tbody>
</table>

**Source:** Thunderbird, The Garvin School of International Management, from Department of Transportation, Bloomberg

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**Figure 2**

sure, Southwest is an excellent operator, which has helped to drive its growth. Superior operations, however, have far more impact when they advance a strategy based on the principles of SMP.

**Bally Total Fitness and Town Sports International Holdings**

The previous example illustrates the power of SMP from a retrospective view. To understand how to look forward and uncover value through the SMP lens, let’s consider a very different context – the health-club industry. If one competes in this industry, and a key goal is to understand and improve SMP, what is the most effective approach to take?

Table II summarizes basic financials for four different growth strategies in the health club sector. Assume that revenue and expense items in the column entitled “Club Details” are the critical drivers in this business. The question to answer is, “What happens along each of these key dimensions as one goes up in organizational scale?”

In the case of a single club in this example, salaries account for 25 percent of revenues and rent constitutes another 15 percent, while advertising and marketing make up just over

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<table>
<thead>
<tr>
<th>Club details</th>
<th>$000s</th>
<th>Single % of revenue</th>
<th>Local (5 locations) $000s</th>
<th>% of revenue</th>
<th>Regional (30 locations) $000s</th>
<th>% of revenue</th>
<th>National (150 locations) $000s</th>
<th>% of revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue ('000)</td>
<td>1,350</td>
<td>100</td>
<td>6,750</td>
<td>100</td>
<td>40,500</td>
<td>100</td>
<td>202,500</td>
<td>100</td>
</tr>
<tr>
<td>Salaries</td>
<td>337</td>
<td>25</td>
<td>1,688</td>
<td>25</td>
<td>10,125</td>
<td>25</td>
<td>50,625</td>
<td>25</td>
</tr>
<tr>
<td>Rent</td>
<td>200</td>
<td>15</td>
<td>1,000</td>
<td>15</td>
<td>6,000</td>
<td>15</td>
<td>30,000</td>
<td>15</td>
</tr>
<tr>
<td>Advertising and marketing</td>
<td>150</td>
<td>11</td>
<td>450</td>
<td>7</td>
<td>1,575</td>
<td>4</td>
<td>7,875</td>
<td>4</td>
</tr>
<tr>
<td>Depreciation</td>
<td>86</td>
<td>6</td>
<td>407</td>
<td>6</td>
<td>2,314</td>
<td>6</td>
<td>11,250</td>
<td>6</td>
</tr>
<tr>
<td>Other expenses</td>
<td>202</td>
<td>15</td>
<td>1,012</td>
<td>15</td>
<td>6,075</td>
<td>15</td>
<td>30,375</td>
<td>15</td>
</tr>
<tr>
<td>Total operation expenses</td>
<td>975</td>
<td>72</td>
<td>4,557</td>
<td>68</td>
<td>26,089</td>
<td>64</td>
<td>130,125</td>
<td>64</td>
</tr>
<tr>
<td>Overhead</td>
<td>338</td>
<td>25</td>
<td>1,321</td>
<td>20</td>
<td>6,038</td>
<td>15</td>
<td>30,188</td>
<td>15</td>
</tr>
<tr>
<td>EBT</td>
<td>37</td>
<td>3</td>
<td>872</td>
<td>13</td>
<td>8,373</td>
<td>21</td>
<td>42,187</td>
<td>21</td>
</tr>
</tbody>
</table>

**Source:** LEK Analysis
11 percent of total revenues. Add in depreciation, other expenses, and then overhead to operate the business as a whole, and it is clear that, in the case of a single club, this is a difficult business. Very few stand-alone clubs approach a 5 percent operating margin.

Now consider how that changes if one operates five clubs all within the same city. This scale of operation will require five times as many fitness instructors, five times as many receptionists, etc., and most likely is going to pay five times the rent. Other expenses such as laundry and cleaning services are also going to increase in proportion to revenue. Consequently, little advantage is gained within these expense categories.

Advertising and marketing, though, are a different matter. One can leverage advertising costs across multiple locations, which has the effect of reducing costs as a percent of revenue by something over a third in this example. In addition, some improvement in depreciation is likely because the cost of purchasing five times the equipment allows for more aggressive negotiations with suppliers.

Overhead, too, should show improvement. Whereas a single operation requires only one general manager, a five-location organization can be structured with one senior general manager who oversees the clubs and a more junior supervisor at each location, resulting in cost savings. Similarly, this structure allows a single individual to be responsible for HR issues, recruitment, etc. Running a five-location operation – provided that those locations are all within a single city – versus a stand-alone operation reduces overhead by roughly 20 percent and will likely result in low double-digit profitability.

One level up in terms of scale is the regional player. Assume this is an organization with 30 locations that are all within a closely-packed geographic region. How are costs impacted in this scenario? Again, salaries, rent and other expenses are likely to remain constant in proportion to revenue, resulting in insignificant real benefits. Further economies in advertising and marketing may be possible, allowing for media insertions in radio and television or in larger newspapers, which might not be possible at a smaller scale. One also can probably further leverage overhead in terms supervisory staffing. As a result, profitability increases from low double digits to something closer to 20 percent or more.

Finally, consider a national operation with 150 locations concentrated within five regions. What impact does this scale have on the economics of the business? There will be minimal improvement in advertising and marketing benefits because media insertions will be purchased across different media markets. Furthermore, little additional benefit from depreciation is available. Extra discounts from suppliers may be possible; but with 30 locations as a regional player, excellent discounts are already in place. In terms of overhead, it is not terribly reasonable to expect that a manager based in Chicago will be effectively positioned to oversee an operation that is on the West Coast or in the Southeast. Regional overhead, therefore, will need to be replicated.

In summary, when shifting from being a regional player to a concentrated national player, one remains profitable, but profitability does not increase significantly. This assumes that shifting from a regional to a national scale is achieved by growing a number of strong regions, which can drive excellent economics.

By comparison, a dispersed national scale operation with 150 facilities that are distributed across 20 or 30 states may not substantially increase value and may, in fact, destroy it. In terms of advertising and marketing, the same economies possible at the regional and concentrated national levels are unavailable because media is purchased across many more markets. Overhead savings are limited because, again, managers must be located across several regions. Depreciation from more effective equipment buying may generate some benefits; but, as noted, those savings are limited because the company is already down the discount curve once it has reached the regional level.

The economics for a dispersed national player, therefore, are substantially worse than those for a strong regional player. Figure 4 illustrates the comparative economics of the aforementioned scenarios.
The goal, of course, is to grow the “profit” segment (at the top of each bar in Figure 4) to the greatest extent possible. Note how the economics of the “Regional” bar (i.e. 30 locations) are almost identical to “National Concentrated” bar (i.e. 150 locations).

To see how this can play out with real companies, consider Bally Total Fitness, an operation with more than 400 health club locations and $800 million in annual revenues[2]. Bally began as a tennis and health club in 1962 and grew to become the largest publicly held health-club operator in the USA[3].

Like Bally, Town Sports International Holdings, Inc. (TSI) has been in business for more than 30 years. With annual revenues of $365 million, it is one of the leading operators of fitness clubs in the Northeast and Mid-Atlantic regions of the USA[4]. TSI is known by its many regional brands: New York Sports Clubs, Boston Sports Clubs, Washington Sports Clubs and Philadelphia Sports Clubs. Table III compares the number of locations for Bally and TSI as of this writing.

Bally pursued a national strategy that did not focus on specific regions. Its strategy resembles the fifth column of Figure 4, making it difficult to realize strong returns from its overall scale. TSI’s strategy, by contrast, focuses on the regional scale: only 11 of the company’s 139 facilities are outside its top three metropolitan markets. Its strategy is best reflected by the fourth column in Figure 4. TSI refers to this strategy as “regional clustering.”

Unlike Bally’s growth plan, TSI’s plan incorporated the three sub-strategies of SMP.

<table>
<thead>
<tr>
<th>Metro area</th>
<th>Bally total fitness</th>
<th>Town sports international</th>
</tr>
</thead>
<tbody>
<tr>
<td>NYC</td>
<td>36</td>
<td>89</td>
</tr>
<tr>
<td>Boston</td>
<td>12</td>
<td>19</td>
</tr>
<tr>
<td>Washington, DC</td>
<td>8</td>
<td>20</td>
</tr>
<tr>
<td>Rest of USA</td>
<td>308</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>364</td>
<td>139</td>
</tr>
</tbody>
</table>

Sources: Company web sites
The approach was creative in that it did not follow the standard model of broad national expansion and instead concentrated on regional development. The result has been an increase in the company's weighted average relative market share as well as higher net present value of cash flows from higher revenues, lower costs, and lower capital requirements.

TSI's regional clustering strategy has had a powerful and positive impact on company profitability, producing operating margins at least 50 percent higher than Bally's margins.

Conclusion

SMP is a proven and highly effective tool for creating value. It is founded on the assumption that not all growth is good – in fact, some growth actually destroys value. SMP helps companies identify the difference and respond accordingly.

By being creative and casting a broad net to maximize the chances of identifying successful strategies, and by applying the SMP and value-creation tests, an organization's leadership can gain valuable insight into organic growth, acquisitions, and other growth investments and be better able to formulate strategies that have the potential to improve the company's overall performance.

Notes

2. Bally's-related financial information is from Business Wire and Bloomberg. Also useful is Wells and Raabe (2005).
3. See the Bally's entry in Wikipedia at en.wikipedia.org/wiki/Bally_Total_Fitness

References

Thunderbird, The Garvin School of International Management, from Department of Transportation (2005), Southwest Airlines 2005, Thunderbird, The Garvin School of International Management, from Department of Transportation, Glendale, AZ.


About the author

Stuart Jackson is the author of Where Value Hides: A New Way to Uncover Profitable Growth for Your Business (Wiley, November 2006) and a vice president with LEK Consulting LLC. He has more than 20 years of consulting experience, starting with LEK Consulting in London before taking over as head of the firm’s Chicago office a decade ago. Stuart Jackson can be contacted at: s.jackson@lek.com

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