

MARKET SHARE-A KEY TO PROFITABILITY

An ongoing study of 57 companies reveals a link between ROI and market share-the bigger the better

Robert D. Buzzell, Bradley T. Gale, and Ralph G.M. Sultan

The March-April 1974 issue of HBR carried an article that reported on Phases I and II of a project sponsored by the Marketing Science Institute and the Harvard Business School. The basic purpose of the project is to determine the profit impact of market strategies (PIMS). The earlier article established a link between strategic planning and profit performance; here, with additional data, the authors come up with a positive correlation between market share and ROI. The authors discuss why market share is profitable, listing economies of scale, market power, and quality of management as possible explanations; then, using the PIMS data base, they show how market share is related to ROI. Specifically, as market share increases, a business is likely to have a higher profit margin, a declining purchases-to-sales ratio, a decline in marketing costs as a percentage of sales, higher quality, and higher priced products. Data also indicate that the advantages of large market share are greatest for businesses selling products that are purchased infrequently by a fragmented customer group. The authors also analyze the strategic implications of the market-share/ROI relationship. They conclude by advising companies to analyze their own positions in order to achieve the best balance of costs and benefits of the different strategies.

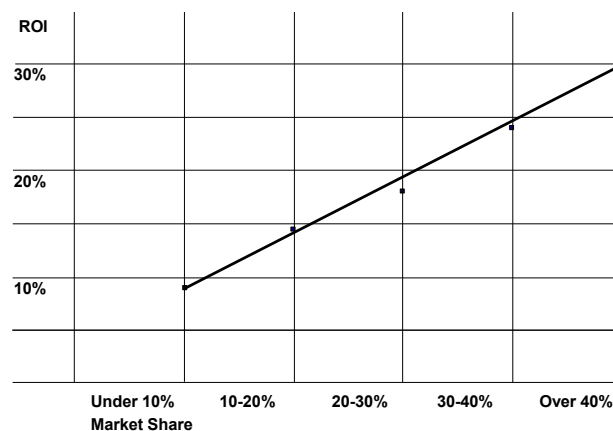
Mr. Buzzell, who is research director of the PIMS project, is professor of business administration and chairman of the marketing area at the Harvard Business School. Mr. Gale, associate professor of economics at the University of Massachusetts-Amherst, is currently on sabbatical to direct the economic analysis of the PIMS project. Mr. Sultan, chief economist of the Royal Bank of Canada, Montreal, was a member of the Harvard Business School faculty. He directed the PIMS project from its inception in late 1971 until early 1973.

Authors' note: We wish to acknowledge the contributions of our associates in the PIMS project to the results reported in this paper. Sidney Schoeffler, Donald F. Heany, and James Conlin made valuable suggestions, and Paula Nichols carried out numerous analyses very efficiently -and cheerfully. The authors are, of course, solely responsible for any errors or misinterpretations that remain.

It is now widely recognized that one of the main determinants of business profitability is market share. Under most circumstances, enterprises that have achieved a high share of the markets they serve are considerably more profitable than their smaller-share rivals. This connection between market share and profitability has been recognized by corporate executives and consultants, and it is clearly demonstrated in the results of a project undertaken by the Marketing Science Institute on the Profit Impact of Market Strategies (PIMS). The PIMS project, on which we have been working since late 1971,¹ is aimed at identifying and measuring the major determinants of return on investment (ROI) in individual businesses. Phase II of the PIMS project, completed in late 1973, reveals 37 key profit influences, of which one of the most important is market share.

There is no doubt that market share and return on investment are strongly related. Exhibit I shows average pretax ROI figures for groups of businesses in the PIMS project that have successively increasing shares of their markets. (For an explanation of how businesses, markets, and ROI results are defined and measured in the PIMS project, see the ruled insert on page 105.) On the average, a difference of 10 percentage points in market share is accompanied by a difference of about 5 points in pretax ROI.

Exhibit I
Relationship between market share and pretax ROI



¹ See the earlier article on Phases I and II of the project by Sidney Schoeffler, Robert D. Buzzell, and Donald P. Heany, "Impact of Strategic Planning on Profit Performance." *HBR* March-April 1974.

While the PIMS data base is the most extensive and detailed source of information on the profit/marketshare relationship, there is additional confirming evidence of its existence. For instance, companies enjoying strong competitive positions in their primary product markets tend to be highly profitable. Consider, for example, such major companies as IBM, Gillette, Eastman Kodak, and Xerox, as well as smaller, more specialized corporations like Dr. Scholl (foot care products) and Hartz Mountain (pet foods and accessories).

Granted that high rates of return usually accompany high market share, it is useful to explore the relationship further. Why is market share profitable? What are the observed differences between Low- and high-share businesses? Does the notion vary from industry to industry? And, what does the profitability/market-share relationship imply for strategic planning? In this article we shall attempt to provide partial answers to these questions by presenting evidence on the nature, importance, and implications of the links between market share and profit performance.

Why market share is profitable

The data shown in Exhibit I demonstrate the differences in ROI between high- and low-market-share businesses. This convincing evidence of the relationship itself, however, does not tell us why there is a link between market share and profitability. There are at least three possible explanations:

□ Economies of scale: The most obvious rationale for the high rate of return enjoyed by large-share businesses is that they have achieved economies of scale in procurement, manufacturing, marketing, and other cost components. A business with a 40% share of a given market is simply twice as big as one with ~0% of the same market, and it will attain, to a much greater degree, more efficient methods of operation within a particular type of technology.

Closely related to this explanation is the so-called "experience curve" phenomenon widely publicized by the Boston Consulting Group.² According to BEG, total unit costs of producing and distributing a product tend to decline by a more or less constant percentage with each doubling of a company's cumulative output. Since, in a given time period, businesses with large market shares generally also have larger cumulative sales than their smaller competitors, they would be expected to have lower costs and correspondingly higher profits.

² Boston Consulting Group, Inc., Perspective On Experience, Boston, 1968 and 1970.

□ Market power: Many economists, especially among those involved in antitrust work, believe that economies of scale are of relatively little importance in most industries. These economists argue that if large-scale businesses earn higher profits than their smaller competitors, it is a result of their greater market power: their size permits them to bargain more effectively, "administer" prices, and, in the end, realize significantly higher prices for a particular product.³

□ Quality of management: The simplest of all explanations for the market-share/profitability relationship is that both share and ROI reflect a common underlying factor: the quality of management. Good managers (including, perhaps, lucky ones!) are successful in achieving high shares of their respective markets; they are also skillful in controlling costs, getting maximum productivity from employees, and so on. Moreover, once a business achieves a leadership position-possibly by developing a new field-it is much easier for it to retain its lead than for others to catch up.

These explanations of why the market-share/profitability relationship exists are not mutually exclusive. To some degree, a large-share business may benefit from all three kinds of relative advantages. It is important, however, to understand from the available

information how much of the increased profitability that accompanies high market share comes from each of these or other sources.

How market share relates to ROI

Analysis of the PIMS data base sheds some light on the reasons for the observed relationship between market share and ROI. Businesses with different market-share levels are compared as to financial and operating ratios and measures of relative prices and product quality in Exhibit II. In examining these figures, remember that the PIMS sample of businesses includes a wide variety of products and industries. Consequently, when we compare businesses with market shares under 10%, say, with those having shares over 40%, we are not observing differences in costs and profits within a single industry. Each subgroup contains a diversity of industries, types of products, kinds of customers, and so on.

³ This general argument has been made in numerous books, articles, and speeches dealing with anti-trust economics, see, for example, Joe S. Bain, Industrial Organization, 2nd edition (New York, John Wiley & Sons, 1968), especially Chapter 6.

Exhibit II

Relationships of market share to key financial and operating ratios for overall PIMS sample of businesses

Financial and operating ratios	Market share				
	Under 10%	10%-20%	20%-30%	30%-40%	over 41%
Capital structure:					
Investment/sales	68.66	67.74	61.08	64.66	63.96
Receivables/sales	15.52	14.08	13.96	15.18	14.48
Inventory/sales	9.30	8.97	8.68	8.66	8.16
Operating results:					
Pretax profit/sales	- 0.16	3.42	4.84	7.80	13.16
Purchases/sales	45.40	39.90	39.40	32.80	33.00
Manufacturing/sales	2964	32.61	32.11	32.95	31.76
Marketing/sales	10.80	9.88	9.05	10.45	8.57
R&D/sales	2.80	2.40	2.83	3.18	3.55
Capacity Utilization					
	74.70	77.10	78.10	75.40	78.00
Product quality:					
average of percents superior minus inferior	14.50	20.40	20.40	20.10	43.00
Relative price*					
	2.72	2.73	2.65	2.66	2.39
Number of businesses					
	156	179	105	67	87

Average value on 5-point scale:

5 = 10% or more lower than leading competitors' average;

3 = within 3% of competition:

1 = 10% or more higher than competition

DIFFERENCES BETWEEN HIGH- AND LOW-SHARE BUSINESSES

The data in Exhibit II reveal four important differences between high-share businesses and those with smaller shares. The samples used are sufficiently large and balanced to ensure that the differences between them are associated primarily with variations in market share, and not with other factors. These differences are:

1

As market share rises, turnover on investment rises only somewhat, but profit margin on sales increases sharply. ROI is, of course, dependent on both the rate of net profit on sales and the amount of investment required to support a given volume of sales. Exhibit II reveals that the ratio of investment to sales declines only slightly, and irregularly, with increased market share. The data show too that capacity utilization is not systematically related to market share.

Exhibit III

Effect of vertical integration on investment/sales ratio

Vertical Integration	Market share				
	Under 11%	10%-40%	20%-30%	30%-40%	over 40%
Low	65	61	46	56	55
High	77	76	75	70	69

Exhibit IV

Purchase-to-sales ratio corrected for vertical integration

Vertical Integration	Market share				
	Under 11%	10%-40%	20%-30%	30%-40%	over 40%
Low	54	51	53	52	46
High	32	27	29	24	23

On the surface then, higher investment turnover does not appear to be a major factor contributing to higher rates of return. However, this observation is subject to some qualification. Our analysis of the PIMS data base shows that investment intensity (investment relative to sales) tends to vary directly with a business's degree of vertical integration.

(The degree of vertical integration is measured as the ratio of the total value added by the business to its sales. Both the numerator and denominator of the ratio are adjusted by subtracting the pretax income and adding the PIMS average ROI, multiplied by the investment.)

Vertical integration thus has a strong negative relation to the ratio of purchases to sales. Since high market-share businesses are on the average somewhat more vertically integrated than those with smaller shares, it is likely that investment turnover increases somewhat more with market share than the figures in Exhibit II suggest. In other words, as shown in Exhibit III, for a given degree of vertical integration, the investment-to-sales ratio declines significantly, even though overall averages do not.

Nevertheless, Exhibit II shows that the major reason for the ROI/market-share relationship is the dramatic difference in pretax profit margins on sales. Businesses with market shares under 10% had average pretax losses of 0.16%. The average ROI for businesses with under 10% market share was about 9%. Obviously, no individual business can have a negative profit-to-sales ratio and still earn a positive ROI. The apparent inconsistency between the averages reflects the fact that some businesses in the sample incurred losses that were very high in relation to sales but that were much smaller in relation to investment. In the PIMS sample, the average return on sales exhibits a strong, smooth, upward trend as market share increases.

Why do profit margins on sales increase 90 sharply with market share? To answer this, it is necessary to look in more detail at differences in prices and operating expenses.

2

The biggest single difference in costs, as related to market share, is in the purchases-to-sales ratio. As shown in Exhibit II, for large-share businesses—those with shares over 40%—purchases represent only 33% of sales, compared with 45% for businesses with shares under 10%.

How can we explain the decline in the ratio of purchases to sales as share goes up? One possibility, as mentioned earlier, is that high-share businesses tend to be more vertically integrated—they "make" rather than "buy," and often they own their own distribution facilities. The

decline in the purchases-to-sales ratio is quite a bit less (see Exhibit IV) if we control for the level of vertical integration. A low purchases-to-sales ratio goes hand in hand with a high level of vertical integration.

Other things being equal, a greater extent of vertical integration ought to result in a rising level of manufacturing costs. (For the nonmanufacturing businesses in the PIMS sample, "manufacturing" was defined as the primary value-creating activity of the business. For example, processing transactions is the equivalent of manufacturing in a bank.) But the data in Exhibit II show little or no connection between manufacturing expense, as a percentage of sales, and market share. This could be because, despite the increase in vertical integration, costs are offset by increased efficiency.

This explanation is probably valid for some of the businesses in the sample, but we believe that, in the majority of cases, the decline in costs of purchased materials also reflects a combination of economies of scale in buying and, perhaps, bargaining power in dealing with suppliers. Economies of scale in procurement arise from lower costs of manufacturing, marketing, and distributing when suppliers sell in large quantities. For very large-scale buyers, custom-designed components and special formulations of materials that are purchased on long-term contracts may offer "order of magnitude" economies.

Still another possible explanation of the declining purchases-to-sales ratio for large-share businesses might be that they charge higher prices, thus increasing the base on which the percentage is figured. This does not, however, appear to be the case.

In Exhibit II we give measures of price relative to competition for each group of businesses that indicate otherwise. Because of the great difficulty of computing meaningful relative price-index numbers, the measure we used here is rather crude. We asked the PIMS participants to indicate on a five-point scale whether their prices were "about the same" as major competitors, "somewhat" higher or lower, or "substantially" higher or lower for each business. The average values of this scale measure are virtually identical for each market-share group, except for those with shares over 40%.

Despite the similarity of relative prices for the first four share groups, the purchases-to-sales ratios decline in a regular, substantial fashion as share increases. In light of this, we do not believe that the decline in purchase costs is a reflection of higher price levels imposed by "market power."

3

As market share increases, there is some tendency for marketing costs, as a percentage of sales, to decline. The difference in marketing costs between the smallest

and largest market-share groups amounts on the average to about 2% of sales. We believe that this reflects true scale economies, including the spreading of fixed marketing costs and the ability of large-share businesses to utilize more efficient media and marketing methods. In the case of industrial products, large scale permits a manufacturer to use his own sales force rather than commissioned agents and, at some point, to utilize specialized sales forces for specific product lines or markets. For consumer goods, large-scale businesses may derive an important cost advantage from their ability to utilize the most efficient mass-advertising media.

In addition, leading brands of consumer products appear to benefit to some extent from a "bandwagon effect" that results from the brand's greater visibility in retail stores or greater support from retail store sales personnel. For example, Anheuser-Busch has for some time enjoyed lower advertising costs per case of beer than its smaller rivals—just as the advertising expense per car of General Motors is significantly lower than that of other competing auto manufacturers.

4

Market leaders develop unique competitive strategies and have higher prices for their higher-quality products than do smaller-share businesses. The figures in Exhibit II do not show smooth, continuous relationships between market share and the various components of price, cost, and investment. Indeed, it appears that one pattern operates as share increases up to 40%, but a somewhat different pattern above that figure.

Particularly, there are substantial differences in relative price and product quality between market leaders and the rest of the sample. Market leaders obtain higher prices than do businesses with smaller market shares. A principal reason for this may be that market leaders also tend to produce and sell significantly higher-quality products and services than those of their lower-share competitors.

We measured quality as follows: We asked the participating companies to judge for each business the proportions of total sales comprised of products and services that were "superior," "equivalent," and "inferior" to those of leading competitors. The figures shown in Exhibit II are averages of the differences between the superior quality and the inferior quality percentages.

The measures we used for relative price and relative quality are not, of course, directly comparable. Thus it is impossible to determine which is greater—the price premiums earned by market leaders, or the differential in the quality of their products. But it is clear that the combination of significantly higher prices and quality

represents a unique competitive position for market leaders.

Market leaders, in contrast to their smaller competitors, spend significantly higher amounts on research and development, relative to sales. As shown in Exhibit II, the average ratio of R&D to sales for the highest-share group of businesses was 3.55% - nearly 40% greater than the ratio for the under-10% share group. This, combined with the quality advantage enjoyed by market leaders, suggests that they typically pursue a strategy of product leadership. Certainly this is consistent with what is known about innovative leaders such as Eastman Kodak, IBM, and Procter & Gamble.

Given that market leaders have a high market share and thus the profitability that goes with it, it is natural to question whether the share and profitability ratio shifts from industry to industry. In other words, do businesses in some kinds of industries need a higher share than others to be profitable?

VARIATIONS AMONG INDUSTRIES

While our analyses of the PIMS data base clearly demonstrate a strong general relationship between ROI and market share, they also indicate that the importance of share varies considerably from one type of industry or market situation to another. Two of the more striking variations are summarized in Exhibit IV. These figures show that:

1

Market share is more important for infrequently purchased products than for frequently purchased ones. For infrequently purchased products, the ROI of the average market leader is about 28 percentage points greater than the ROI of the average small-share business. For frequently purchased products (those typically bought at least once a month), the correspondingly ROI differential is approximately 10 points.

Why? Infrequently purchased products tend to be durable, higher unit-cost items such as capital goods, equipment, and consumer durables, which are often complex and difficult for buyers to evaluate. Since there is a bigger risk inherent in a wrong choice, the purchaser is often willing to pay a premium for assured quality.

Frequently purchased products are generally low unit-value items such as foods or industrial supplies. The risk in buying from a lesser-known, small-share supplier is lower in most cases, so a purchaser can feel free to shop around.

2

Market share is more important to businesses when buyers are "fragmented" rather than concentrated. As

Exhibit V shows, when buyers are fragmented (i.e., no small group of consumers accounts for a significant proportion of total sales), the ROI differential is 27 percentage points for the average market leader. However, when buyers are concentrated, the leaders' average advantage in ROI is reduced to only 19 percentage points greater than that of the average small-share business.

A likely explanation for this is that when buyers are fragmented, they cannot bargain for the unit cost advantage that concentrated buyers receive, thus allowing higher profits for the large-share business. Obviously, then, the ROI differential is smaller when buyers are somewhat concentrated. In this case, powerful buyers tend to bargain away some of the seller's cost differential by holding out for low prices.

Clearly, the strategic implications of the marketshare/profitability relationship vary according to the circumstances of the individual business. But there is no doubt that the relationship can be translated into dynamic strategies for all companies trying to set market goals.

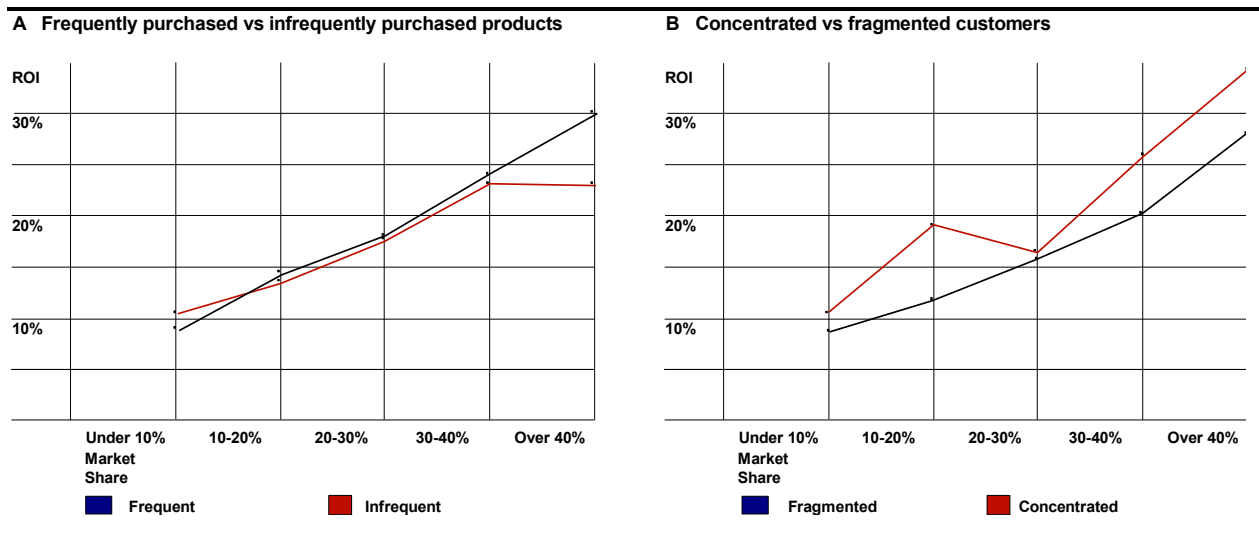
What the ROI/market share link means for strategy

Because market share is so strongly related to profitability, a basic strategic issue for top management is to establish market-share objectives. These objectives have much to do with the rate of return that can reasonably be budgeted in the short and long runs, as well as the capital requirements and cash flow of a business.

SETTING MARKET-SHARE GOALS

What market-share goals are feasible, or even desirable, obviously depends on many things, including the strength of competitors, the resources available to support a strategy, and the willingness of management to forgo present earnings for future results. At the risk of oversimplification, we can classify market-share strategies into three rather broad groups:

Exhibit V
Industry variations In the share/ROI relationship



- 1 Building strategies are based on active efforts to increase market share by means of new product introductions, added marketing programs, and so on.
- 2 Holding strategies are aimed at maintaining the existing level of market share.
- 3 Harvesting strategies are designed to achieve high short-term earnings and cash flow by permitting market share to decline.

When does each of these market-share strategies seem most appropriate? How should each be implemented? The experiences documented in the PIMS data base provide some dues.

BUILDING STRATEGIES

The data presented in Exhibit I imply that, in many cases, even a marginally acceptable rate of return can be earned only by attaining some minimum level of market share. If the market share of a business fails below this minimum, its strategic choices usually boil down to

two: increase share or withdraw. Of course there are exceptions to this rule.

But we are convinced that in most markets there is a minimum share that is required for viability. REA and General Electric apparently concluded that they were below this minimum in the computer business, and they pulled out. Similarly, Motorola, with an estimated 6% to 7% share of U.S. TV-set sales, and a rumored loss of \$20 million in the period from 1970 to 1973, announced its intention early in 1974 to sell the business to Matsushita.

On the other hand, when share is not so low as to dictate withdrawal, but is still not high enough to yield satisfactory returns, managers can consider aggressive share-building strategies. They should recognize, however, that (a) big increases in share are seldom achieved quickly; and (b) expanding share is almost always expensive in the short run.

Among the 600 businesses in the PIMS sample, only about 20% enjoyed market share gains of 2 points or more from 1970 to 1972. As might be expected, successful building strategies were among relatively new businesses. Of those that have begun operations since 1965, over 40% achieved share increases of 2 points or more—compared with only 17% of the businesses established before 1950.

Generally speaking, businesses that are building share pay a short-run penalty for doing so. Exhibit VI compares ROI results for businesses with different beginning market shares and for businesses with decreasing, steady, and increasing shares over the period 1970 to 1972. Generally, the businesses that were "building" (i.e., had share increases of at least 2 points) had ROI results of 1 to 2 points lower than those that maintained more or less steady ("holding") positions. The short-term cost of building was

Exhibit VI
How ROI is affected by market-share changes

Market share 1970	Market share strategies		
	Building: up 2 points or more	Holding: less than 2 points up or down	Harvesting: down 2 points or more
	Average ROI, 1970-1972		
Under 10%	7.5%	10.4%	10.0%
10%-20%	13.3	12.6	14.5
20%-30%	20.5	21.6	9.5
30%-40%	24.1	24.6	7.3
40% or over	29.6	31.9	32.6

greatest for small-share businesses, but even for market leaders, ROI was significantly lower when share was rising than it was when share was stable.

Schick's campaign to build sales of the "Flexamatic" electric shaver during 1972 and '73 dramatically

illustrates the cost of increasing market share. In late 1972 Schick introduced the Flexamatic by means of a controversial national advertising campaign in which direct performance comparisons were made with its leading competitors. Trade sources have estimated that Schick spent \$4.5 million in 1972 and \$5.2 million in 1973 on advertising, whereas the company's advertising expenditures in 1970 and 1971 had been under \$1 million annually.

In one sense the effort was successful: by late 1972 Schick's market share had doubled from 8% to 16%. But the impact on company profits was drastic. Schick's operating losses for the fiscal year ending February 28, 1974 amounted to \$14.5 million on sales of \$93.8 million, and it appears that although it was not the only cause, the high promotional cost of the Flexamatic campaign was a major contributing factor. Only time can tell whether Schick's short-term losses will prove to be justified by increased future cash flows.

The Schick example is, no doubt, an extreme one. Nevertheless, a realistic assessment of any share-building strategy should take into account the strong likelihood that a significant price will have to be paid—at least in the short run. Depending on how great the gains are and how long it takes to achieve them, this cost may or may not be offset by the longer-term gains.

In a recent article, William Fruhan demonstrated that there was a positive relation between market share and rate of return for automobile manufacturers and for retail food chains.⁴ Yet he also cited examples of disasters stemming from overambition in the market-share dimension from the computer industry, the retail food business, and the airline companies.

The main thrust of Fruhan's article was to encourage business strategists to consider certain questions before launching an aggressive market-share expansion strategy: (1) Does the company have the necessary financial resources? (2) Will the company find itself in a viable position if its drive for expanded market share is thwarted before it reaches its market share targets? (3) Will regulatory authorities permit the company to achieve its objective with the strategy it has chosen to follow? Negative responses to these questions would obviously indicate that a company should forgo market-share expansion until the right conditions are created.

It is fairly safe for us to say, therefore, that whenever the market position of a business is reasonably satisfactory, or when further building of share seems excessively costly, managers ought to follow holding strategies.

⁴ "Pyrrhic Victories in Fights for Market Share," *HBR* September-October 1972.

HOLDING STRATEGIES

By definition, a holding strategy is designed to preserve the status quo. For established businesses in relatively mature markets—which is to say, for the majority of businesses in advanced economies—holding is undoubtedly the most common strategic goal with respect to market share.

A key question for businesses that are pursuing holding strategies is, "What is the most profitable way to maintain market position?" The answer to this question depends on many things, including the possibilities and costs of significant technological change and the strength and alertness of competitors. Because competitive conditions vary so much, few reliable generalizations can be made about profit-maximizing methods of maintaining market share.

Nevertheless, our analyses of the PIMS data base do suggest some broad relationships between ROI and competitive behavior. For example, our data indicate that large-share businesses usually earn higher rates of return when they charge premium prices. (Recall that this pricing policy is usually accom

panied by premium quality.) Also, ROI is usually greater for large-share businesses when they spend more than their major competitors, in relation to sales, on sales force effort, advertising and promotion, and research and development.

For small-share businesses, however, the most profitable holding strategy is just the opposite: on the average, ROI is highest for these businesses when their prices are somewhat below the average of leading competitors and when their rates of spending on marketing and R&D are relatively low.

THE PIMS DATA BASE

The data on which this article is based come from the unique pool of operating experience assembled in the PIMS project, now in its third year of operations at the Marketing Science Institute. During 1973, 57 major North American corporations supplied financial and other information on 620 individual "businesses" for the three-year period 1970-1972.

Each business is a division, product line, or other profit center within its parent company, selling a distinct set of products or services to an identifiable group or groups of customers, in competition with a well-defined set of competitors. Examples of businesses include manufacturers of TV sets; man-made fibers; and nondestructive industrial testing apparatus.

Data were compiled for individual businesses by means of special allocations of existing company data and, for some items, judgmental estimates supplied by operating managers of the companies.

For each business, the companies also provided estimates of the total sales in the market served by the business. Markets were defined, for purposes of the PIMS study, in much narrower terms than the "industries" for which sales and other figures are published by the Bureau of the Census. Thus the data used to measure market size and growth rates cover only the specific products or services, customer types, and geographic areas in which each business actually operates.

The market share of each business is simply its dollar sales in a given time period, expressed as a percentage of the total market sales volume. The figures shown are average market shares for the three-year period 1970-1972. (The average market share for the businesses in the PIMS sample was 22.1%.)

Return on investment was measured by relating pretax operating profit to the sum of equity and long-term debt. Operating income in a business is after deduction of allocated corporate overhead costs, but prior to any capital charges assigned by corporate offices. As in the case of market share data, the ROI figures shown in Exhibit I, V, and VI are averages for 1970-1972.

As explained in the earlier HBR article, the focus of the PIMS project has been primarily on ROI because this is the performance measure most often used in strategic planning. We recognize, however, that ROI results are often not entirely comparable between businesses. When the plant and equipment used in a business have been almost fully depreciated, for example, its ROI will be inflated. Also, ROI results are affected by patents, trade secrets, and other proprietary aspects of the products or methods of operation employed in a business. These and other differences among businesses should naturally be kept in mind in evaluating the reasons for variations in ROI performance.

HARVESTING STRATEGIES

Opposed to a share-building strategy is one of "harvesting" - deliberately permitting share to fall so that higher short-run earnings and cash flow may be secured. Harvesting is more often a matter of necessity than of strategic choice. Cash may be urgently needed to support another activity—dividends, for example, or

management's earnings record. Whatever the motivation, corporate management sometimes does elect to "sell off" part of a market-share position.

The experience of the businesses in the PIMS data pool, summarized in Exhibit VI, indicates that only large-share businesses are generally able to harvest

successfully. Market leaders enjoyed rates of return about three quarters of a point higher when they allowed market share to decline than when they maintained it over the period 1970-1972. For the other groups of businesses shown in Exhibit VI, differences in ROI between "holding" and "harvesting" are irregular. Of course, these comparisons also reflect the influence of factors other than strategic choice. Market share was lost by many businesses because of intensified competition, rising costs, or other changes which hurt both their profitability and their competitive positions. For this reason, it is impossible to derive a true measure of the profitability of harvesting. Nevertheless, the PIMS data support our contention that, under proper conditions, current profits can be increased by allowing share to slide.

When does harvesting make sense, assuming it is a matter of choice? A reduction in share typically affects profits in a way directly opposite to that of building: ROI is increased in the short run but reduced in the longer term. Here again, a trade-off must be made. The net balance will depend on management's assessment of the direction and timing of future developments such as technological changes, as well as on its preference for immediate rather than deferred profits.

Balancing costs and benefits

Evidence from the PIMS study strongly supports the proposition that market share is positively related to the rate of return on investment earned by a business. Recognition of this relationship will affect how managers decide whether to make or buy to decrease purchasing costs, whether to advertise in certain media, or whether to alter the price or quality of a product. Also, recognizing that emphasis on market share varies considerably among industries and types of market situations, decisions concerning product and customer are likely to be influenced. For instance, a small competitor selling frequently purchased, differentiated consumer products can achieve satisfactory results with a small share of the market. Under other conditions, it would be virtually impossible to earn satisfactory profits with a small share (e.g., infrequently purchased products sold to large, powerful buyers).

Finally, choices among the three basic market share strategies also involve a careful analysis of the importance of market share in a given situation. Beyond this, strategic choice requires a balancing of short-term and long-term costs and benefits. Neither the PIMS study nor any other empirical research can lead to a "formula" for these strategic choices. But we hope that the findings presented here will at least provide some useful insights into the probable consequences of managers' choices.

Size by itself has major impact on strategy. And strategy, in turn, has major impact on size. The small organization can do things the large ones cannot do. Its simplicity and its small size should give it fast response, agility, and the ability to focus its resources. But the large organization, in turn, also can do things the small organization cannot do. It can commit resources for a much longer time, for instance, to long-term research projects which are beyond the staying power of the small business. The question "What strategies benefit different sizes?" is thus of crucial importance to top management.

From the book *Management: Tasks, Responsibilities, Practice*, 1973, 1974 by Peter F. Drucker; reprinted by permission of Harper & Row, Publishers, p. 640.

Source : *Harvard Business Review*, January-February 1975, p. 97-106.