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Choose Profit over Market Share

According to authors Hermann Simon (Chairman) and Frank Bilstein (Executive Vice President) of Simon-Kucher & Partners, "aggressive" pricing strategies in contested markets rarely work effectively. Instead, they demonstrate that companies which are oriented to profits rather than market share ultimately do better, while avoiding the kinds of price wars that can destroy all participants. The authors can be reached at: hermann.simon@simon-kucher.com and frank.bilstein@simon-kucher.com, respectively. This article was first published in CEO, Chief Executive Officer, *2008, SPG Media Ltd.*

In the summer of 2003 the CEO of a world-renowned public company was presented with a sophisticated strategy that would secure its path towards profitable growth. She waited with growing impatience for the end of the presentation to crush six months of work with one sentence: "That's all very well and good, but I want to destroy my competitors!"

Aggression usually means aggressive prices, and this strategy seldom works. In the years since then the company has drastically reduced its formerly attractive margins in numerous important markets, but despite these strong attacks it has not succeeded in ousting even one competitor.

This example reflects the mindset of many established companies with leading market positions. They believe they can minimize or eliminate competitors through aggression, even in mature markets with limited growth where firms have long ceased to offer any superior benefits.

Aggression usually means aggressive prices, but this strategy seldom works. As revealed in the case above, the competitors usually survive and everyone ends up with less profit.

The problems of the world's leading PC manufacturer Dell offer a good example. After Dell clinched the top position in its market through a price war in 2001, the two arch-rivals Compaq and Hewlett-Packard reacted by merging their businesses. IBM's laptops are now in the hands of the world's number-three manufacturer, the Chinese company Lenovo, which is in the process of re-establishing its cost leadership. It is no wonder that the stock market keeps asking when Dell is going to start benefiting from its aggression.

Profit-Oriented Management

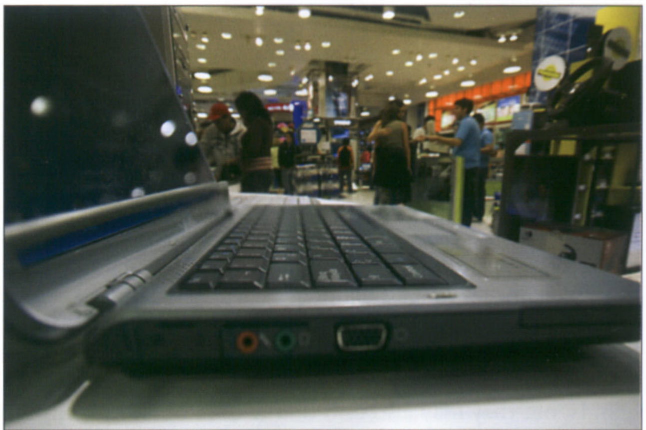
The companies' and investors' mindset is moving away from market-share orientation towards profit-oriented management. Lothar Meyer, CEO of Germany's second largest insurance group Ergo, announced in a recent press conference that it will stay out of a price war in the automotive and industrial insurance businesses: "We would also accept some loss of market share."

In January 2007 Bob Lutz, Vice Chairman of General Motors (GM), declared that "within reason it would be better to sell slightly fewer [vehicles] at higher margins. We've tried to sell more at lower margins, and it's what got General Motors into trouble."

The GM case is especially intriguing: Just over a year has gone by since the company subjected itself to one of the biggest discount battles in history. This action forced its competitors Ford and Chrysler into a price war that had little effect other than burning money. Not only did the minimum target remain unfulfilled, but GM's market shares sank even further.

The stock market can differentiate between what market-share gain is good and what is bad. In one of its last quarterly reports, Amazon justified its weakening margins by its plan to expand its market position even further. Despite a 22% revenue increase that was purchased through lower prices and free delivery, the stock price initially dropped more than 20%.

Deutsche Telekom wasn't spared either



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as it announced last May that it would give priority to revenue over profit in order to regain market share. The shares fell below the IPO level.

How can an established company adapt its competitive strategy to avoid fatal mistakes? Three areas have proven to be particularly important: mindset, planning and communication.

Mindset

Make the following insight the foundation of your mindset: Business is not war!

The primary goal of a company is to satisfy the customer and to generate profits, not to destroy the competition. That is the core of profit-oriented management. If there is no true innovation, then a choice has to be made between market-share growth and profit growth.

Management must be re-educated to understand the benefits of peaceful competition and to realize that price wars only destroy the profit potential of the entire market. This must also be reflected in the company's incentive systems.

Planning

Once the mindset change is complete, the competitive strategy must be reoriented. In which markets should we refrain from aggressive measures against competitors either because it cannot be done profitably and sustainably, or because we do not deserve a bigger market share? And where do we have to hit back hard at competitive actions?

To fight on price against "free" is a hard battle to win profitably. When the *Evening Standard* was attacked by two free afternoon papers (*London Lite* and *thelondonpaper*) in August 2006, it reacted with a price increase of 25%. This was a smart move as its circulation had only dropped 12% by January 2007, and thus its cover revenue actually increased.

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Communication

The new competitive strategy only works if the market understands what the company wants. Otherwise, employees, customers, competitors and investors could interpret deliberate restraint as a sign of weakness, or an intentional defense as a full offensive attack—with fatal results.

This clarity can be achieved through consistent actions and explicit public communications in the media regarding profit orientation. AOL's CEO in Germany was recently asked if the company would have to pick up steam.

He responded: "If picking up steam means more revenue, then maybe; but we place greater emphasis on profitability, for which our growth is just right."

The following people also contributed to this article: Ian Hunter, Head, Bird & Bird's UK Employment Practice; Jonathan Goldsworthy, Associate, International Employment Group.

Editor's Note: "Preismanagement" (3rd edition, 2008) by Hermann Simon and Martin Fassnacht has just been published in German by Gabler Verlag, 2009. The book costs €59.90 and is available at Amazon: http://www.amazon.de/Preismanagement-Strategie-Analyse-Entscheidung-Umsetzung/dp/3409391428/ref=sr_1_1?ie=UTF8&s=books&qid=1227601045&sr=1-1.