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The 'Myth of Market Share': Can Focusing Too Much on the Competition Harm Profitability?

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It is a common practice of many companies to focus their attention on grabbing market share from their competitors. But such efforts can actually be detrimental to the firm's profitability, according to Wharton marketing professor J. Scott Armstrong (http://www.wharton.upenn.edu/faculty/armstroj.html).

For years, Armstrong has been conducting research showing that competitor-oriented objectives, such as setting market-share targets, are counterproductive. After co-authoring a paper in 1996 that reached this conclusion, he and a different co-author, Kesten C. Green of Monash University in Australia, have written another paper summarizing 12 new studies that add additional weight to the original conclusion. Their study is titled, "Competitor-oriented Objectives: The Myth of Market Share."

Business has long been likened to warfare, Armstrong says, so it is hardly surprising that companies want to beat their competitors. In the 19th century, it was common for many American executives to strive for revenue maximization. To see how well they were doing, companies compared themselves to competitors in their industries. But in the mid-20th century some academic scholars began to question the widespread focus on market share. In 1959, one researcher "lamented the common use of market-share objectives and discussed the logical and practical flaws of pursuing such objectives," according to Armstrong and Green.

In the 1996 paper, Armstrong and Fred Collopy of Case Western Reserve University summarized a host of studies by other researchers that examined the prevalence of competitor-oriented objectives.

For instance, several researchers in the 1950s and 1960s had groups of subjects play repeated games in which cooperation was necessary to maximize profits. The researchers found that when they provided feedback to subjects on other subjects' performance, nearly 90% of the choices that the subjects made were competitive and hence low-profit. In another example, Armstrong and Collopy asked 170 MBA students over a period of years whether the "primary purpose of the firm is (a) to do better than its competitors, or (b) to do the best it can." One-third of the students chose (a), suggesting that a large number of the students believed that beating the competition is more important than other goals, including profitability.

In their 1996 study, Armstrong and Collopy also analyzed data amassed by scholars to measure the level of competitor orientation of 20 major corporations, as stated by the companies themselves, and how the level of competitor orientation was related to the firms' after-tax return on investment (ROI) for five nine-year periods beginning in 1938 and ending in 1982. "Competitive-oriented objectives were negatively correlated with ROI for these data," Armstrong and Collopy concluded. In other words, the more managers tried to be the biggest in their market, the more they harmed their own profitability.

For example, companies whose only goal was profit maximization -- DuPont, General Electric, Union Carbide and Alcoa -- posted stronger returns on investment than did the other firms studied. By contrast, the six firms whose only goal was market share -- National Steel, the Great Atlantic & Pacific Tea Company, Swift, American Can, Gulf and Goodyear -- fared worse in terms of ROI. Indeed, some of these companies, like National Steel and American Can, no longer exist.

Armstrong acknowledges that the 1996 paper was controversial. Aside from some coverage in the popular press, corporate executives largely ignored the study and academics criticized it. Since 1996, however, Armstrong and Green have continued their efforts to collect data on the effect of competitor-oriented objectives. They have incorporated the results of these efforts into their new paper.

Competition vs. Cooperation

Once again, Armstrong and his co-author examined both laboratory and field studies conducted by other researchers. One lab study compared the performance of MBA students with that of computerized profit maximizing pricing strategies. Each game involved three players. The subjects were unaware that in two out of three games the third player was one of the computerized strategies. The game was designed to represent the market for mature, frequently purchased consumer goods. It was possible for cooperative players to make a profit of $20 if they all charged $1.50 per unit. Subjects playing the roles of managers were instructed to maximize their profits and were told that their compensation would be partly based on their profitability.

Despite these instructions, the students tended to charge close to the price that maximized the gap between their own profit and that of the other subjects. When the students played against other students only (i.e., there was no computer player),the average profit was $7.19, well below the potentially achievable cooperative profit of $20.

In another study, a team of researchers including Armstrong analyzed additional data, through 1997, on the 20 companies originally studied by Armstrong and Collopy. The researchers introduced two new criteria: real return on equity and the percent of after-tax return on sales. All of the correlations between competitor-oriented objectives and profits were negative, ranging from minus 0.28 to minus 0.73, according to Armstrong and Green.

These two studies -- and others that are recounted in the Armstrong and Green paper -- strengthen the authors' assertion that the oft-touted advice to chase market share in order to achieve greater profitability, is a harmful myth.

In addition, Armstrong and Green write, they "have not found a single paper that challenges the finding that competitor-oriented objectives harm profitability. While advocates of market-share objectives have provided no evidence to support their contention, their writings seem to have had a big impact" on strategic-management research and executives' beliefs that increasing market share is a worthwhile goal. Armstrong and Green also note that many management textbooks erroneously "repeat the claim that increasing market share will boost profitability."

Toyota and Canon

In an interview with Knowledge@Wharton, Armstrong pointed to contemporary examples that appear to underscore his long-held contention about the myth of market share.

For instance, Toyota is a profitable company and expects to build more vehicles than any other automaker in 2007, but grabbing market share is apparently not one of its goals. An Associated Press story on Toyota's imminent rise to the top described Kazuo Okamoto, executive vice president, as being "nonchalant" about Toyota's achievement. "We aren't that concerned about vehicle numbers," Okamoto told the AP. "But we are determined to go at it to develop cars that make a lot of people happy." Indeed, researchers have long known that, in general, Japanese automakers shun market share as an objective, according to Armstrong.

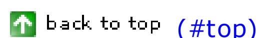
As another example, Armstrong points to two longstanding competitors in the printer and copier business, Canon and Xerox. During the period that Fujio Mitarai was CEO and president of Canon USA -- from 1979 to 1989 -- the value of Canon's stock rose by a factor of nine times while the value of Xerox shares was virtually unchanged. "I changed the mindset at Canon by getting people to realize that profits come first," Mitarai told *BusinessWeek* in a story published in 2002. Mitarai is now chairman and CEO of Canon in Japan.

The harm that competitor-oriented objectives can cause the companies that pursue them was the subject of a December 4, 2006, article in *The New Yorker* by James Surowiecki, the magazine's business writer. Surowiecki describes how Sony, with its PlayStation 3, and Microsoft, maker of the Xbox 360, are beating each other's brains out trying to capture the biggest share of the video-game market. Meanwhile, third-place Nintendo, with its new game console called Wii (pronounced "wee"), has quietly become the most profitable game console company in Japan.

Nintendo "has not just survived out of the spotlight; it has thrived," Surowiecki writes. "It has $5 billion in the bank from years of solid profits, and this past year, though it has spent heavily on the launch of the Wii, it made close to a billion dollars in profit and saw its stock price rise by 65%. Sony's game division, by contrast, barely eked out a profit and Microsoft's reportedly lost money. Who knew bringing up the rear could be so lucrative?"

Armstrong says the focus on beating the competition remains entrenched in the world's biggest companies. Jack Welch, the former CEO of General Electric, famously stated that GE would not be in any business in which it could not be first or second in market share. Welch's belief in the myth still holds sway in boardrooms, but Armstrong says it is never too late for CEOs to change.

"We're not saying companies shouldn't pay attention to their competitors; they might be doing reasonable things that you may also want to do," Armstrong says. "What we're saying is that the objective should not be to try to beat your competitor. The objective should be profitability. In view of all the damage that occurs by focusing on market share, companies would be better off not measuring it."



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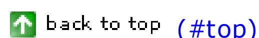

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