

# Reaching for value

## Gaining the edge in new business development

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Increasing numbers of companies today are using a tool called strategic market positioning (SMP) to achieve profitable growth and add value. Simply stated, a “strategic market position” (also abbreviated as SMP) is your company’s share of the strategic market segments that define competitive advantage within your industry – whether defined by geography, customer demographic, channel focus, or whatever the critical dimensions of scale for your business may be. In short, SMP is a management discipline that ties together the fundamental principles of customer preference and producer economics with the goal of achieving strong market positions and higher profitability through selective growth.

As I noted in my column in the last issue of *JBS*, strategic market positioning is frequently used to answer questions about which existing products and services the company wants to offer and promote, which channels should be emphasized, and which customers should be served. A more sophisticated and nuanced approach than (for example) activity-based costing, SMP lets the company leverage its competitive position by gaining the *right* market share while helping to identify areas where investment may actually destroy value.

A quick example: in 1990, America West and Southwest Airlines both had about a 2.25 percent national market share. But Southwest had on average a 30 percent share of flights between “city pairs” served, versus about 10 percent for America West. In this industry, *share of flights between city pairs* is the dimension of market share that drives competitive advantage and profitability. Southwest prospered; America West floundered. Southwest put its money where it would make the biggest payback;

America West – which based its strategy on the conventional measure of overall share of the airline market – did not. So when a company looks at new products or services, it needs to ask: “Will the proposed new business make the average SMP for our overall company better, or will it make it or worse?”

Most companies, once exposed to SMP, embrace its fundamental principles. Sooner or later, though, they tend to ask a logical question: if SMP is all about playing to our strengths – which of course tend to concentrate in those sectors where we’ve been doing business successfully for years – how do we ever do anything *new*? How do we break the mold, leapfrog over the competition, and achieve the double-digit growth that our plan anticipates, and which our shareholders are clamoring for?

The short answer is: you use your existing strengths as your jumping-off point. You build SMPs that are related in significant ways to your existing SMPs.

How do you get there? Let’s assume that you have a new product launch in your crosshairs. A starting point is to ask and answer the following three questions:

1. What strategic segment are we entering, and who is the competition?
2. Will the new business improve our SMP in segments where we already compete?
3. If we are entering a new strategic segment, can we leverage our SMP in adjacent segments to ensure that we achieve a strong SMP in the target segment?

The first question simply encourages you to be rigorous about both identifying the strategic segment for

the new product and figuring out who's already there. Some recent business books, including the bestselling *Blue Ocean Strategy*, have argued that companies are better off competing in "blue oceans" – that is, new and uncontested market spaces – rather than in "red oceans." Red oceans, it seems, are the bloody battlegrounds in which existing companies slug it out for existing market share. "The only way to beat the competition," the authors of *Blue Ocean Strategy* conclude, "is to stop trying to beat the competition."

Well, the image of a tranquil blue ocean – full of fat and slow-moving fish, where no one has thought to fish before – is very appealing. But in the real world, life mostly isn't like that. True, sometimes a genius stumbles upon a blue ocean, but that's not a strategy to bet the company on.

What if somebody's already there? If they're big and you're little, the deck is enormously stacked against you. For an illustration, look at the US food and beverage industry. Between 1997 and 2000, the leading players in each product category accounted for only about 25 percent of the 9,300 new product launches – but that 25 percent comprised around 85 percent of all sales achieved by those launches. In other words, the average sales achieved by a new product launch from a well-established competitor were *17 times higher* than for a company with a weak SMP.

No, that doesn't mean that the smaller guys can never achieve a big hit. It can happen – and when it does, people tend to take notice and talk about it. But it is easy to forget that of the thousands of failed product launches that simply disappeared, the vast majority were from companies that were at a big disadvantage against segment leaders in terms of resources, distribution, logistics, and efficiency.

Questions 2 and 3 in the list above really aim to get you thinking rigorously about how this new product launch will help, and be helped by, your existing SMPs. To make the point, let's look at two moves made by Baxter International in 2001. At that time, Baxter had three divisions, all of which sought to expand their lines of products and services, both through internal development and acquisition.

In addition, Baxter supported an innovation incubator called "Non-Traditional Research and Innovation" or NTRI. One of NTRI's first ventures was an entry in what might be called the "nutritional water" market. Baxter spotted this opportunity well before anyone else, and it *seemed* to make sense: bottled water in the US was a \$25 billion industry, and nutritional supplements were growing at double-digit rates. Baxter had extensive experience in nutritional solutions and understood the solution-container business. Why couldn't Baxter jump in where Abbott Laboratories had ventured 25 years earlier, and done well for themselves? Fourteen months later, Baxter's "PULSE" product line hit the market.

It was a disaster. Simply put, Baxter was leaving behind its strengths and entering an entirely new strategic market segment: one that was crowded with established players. These included not only Abbott, but also huge soft-drink players with massive advantages in marketing and logistics. In addition, PULSE was an institutional orphan, which had been rejected by Baxter's three divisions.

The second move that Baxter made in 2001 involved the purchase of Cook Pharmaceuticals, a Bloomington, Indiana-based manufacturer of parenterals (i.e. drugs that enter the body by a route other than the mouth). The deal was conceived and executed by one of Baxter's three mainline divisions. It clearly "built out of" Baxter's established SMP in medication delivery through IV bags and other specialized systems, and "built into" an adjacent SMP. Both the new and the old SMP were strengthened as a result. The numbers aren't public, but the available evidence seems highly positive: Between 2001 and 2003, the new "Baxter Pharmaceutical Solutions" company doubled its employee base and embarked upon a \$100 million expansion program in Bloomington.

Emphatically, SMP does *not* mean you never enter new businesses. Often, there are ways to support and strengthen existing market positions while taking your company into entirely new lines of business. Consider the following examples:

- Best Buy's expansion from retailing into computer services. The \$3 million acquisition of Geek Squad created a \$600 million service business within four years and brought new types of customers into the stores.
- UPS's expansion into shipping supplies retailing. The \$200 million acquisition of Mail Boxes Etc. provided 4,300 new UPS collection points and helped UPS gain market share worth billions of dollars.
- General Electric's expansion into aircraft engine servicing. Entry into the \$37 billion engine overhaul business enabled GE Engines to provide bundled product and services helping the division achieve higher profitability and faster growth than competitors.

Nor does SMP replace standard tools like market analysis and discounted cash flow. In fact, it supplements those tools. It adds a *strategic* dimension. In order to earn returns above the weighted cost of capital, you have to have some special advantage that isn't open to other competitors. Well, what *is* that advantage? Will you grow faster? Will you leverage some costs from within the same strategic segment, and therefore enjoy lower costs? Will you share some of the same manufacturing infrastructure across your businesses (current and proposed) so that you have a lower investment threshold than other investors would? Exactly what – in terms of either higher revenues, or lower costs, or lower investment requirements – will let you achieve returns above the cost of capital, and find hidden value for your shareholders?

SMP puts you in a much better position to make realistic business forecasts that reflect your competitive advantage. It puts you in a much better position to explain to top management or directors why your proposed initiative makes strategic sense, and how your financial targets will be achieved.

SMP helps you move into the right new market spaces, and stay out of the wrong ones.