

profit impact of market strategy (PIMS)

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What determines profit in a business over time is the “Holy Grail” of strategic management and marketing. Good strategy should yield good performance, yet the latter can differ markedly from business to business. The search for the factors that explain this variability, and to quantify their impacts, has been at the base of the profit impact of market strategy (PIMS) project for over 40 years.

HISTORY

PIMS was founded on failure. Scenario gazing in the diversified General Electric (GE) company (jet engines to television) in the early 1970s had targeted the coming Information Technology (IT) boom as the one sector to provide future “rents.” Computer firms were enjoying higher than average margins and the breadth of the applied technology meant that market opportunities for new entrants were plentiful. As an experienced and large technology company, GE thought it could take on the incumbent giant, IBM. It lost nearly a billion dollars in the attempt (Roberts, 2010). GE reacted by re-evaluating the way it assessed business opportunities analytically. Using data from its own strategic business units (SBUs), it tried to work out “which business pays?, why?, when?, and where?” Thus, the origins of a “profit impact” type project were born under Sydney Schoeffler at GE, who developed a “Profit Optimising Model,” which steered future SBU plans and forecasts.

To build on this work, PIMS began in a formal form under the Marketing Science Institute in 1970¹. PIMS research economists Schoeffler and Gale were joined by Harvard marketing professors, Sultan and Buzzell. Large US companies (57 by 1972 and more than 500 later) were persuaded to join the program and contribute data on performance indicators in their SBUs; particularly around market and industry characteristics (including competitors), the start-off position of the business unit and the strategies were adopted over a specified period. Participant companies were keen to

know just what return on investment (ROI) might emerge from a given sector structure if a certain strategy were followed (*ceteris paribus*). Moreover, will a strategy modification increase profit? What would be an optimum portfolio spread of investments for a certain business? (Buzzell, 2004). So the researchers got to grips with elementary econometric regressions, using ROI as a dependent variable and the market and strategy characteristics as explanatory variables, to provide the “sponsoring” companies with their answers². As Buzzell points out:

Among the most important influences in the “PAR ROI” model were market share, relative product quality, capital intensity, capacity utilisation, labour productivity and the growth rate of an SBU’s served market.

Buzzell, 2004; p. 479.

FINDINGS OR LAWS?

By 1986, this model explained about 40% of the variance in ROI for the SBUs. The team went on to broaden their research into analyses of market structures and shares, entries and exits, vertical integration, and new business ventures. After significant testing across a variety of sectors, the PIMS’ researchers established a set of findings that, they claimed, held consistently between businesses and through time. Among their nine basic findings (Roberts, 2011), they established nine strategic drivers of profitability and net cash flow:

- *Asset utilization* the use of “lean” technology helps profit and cash flow but high automation slows ROI and sales
- *Customer preference* for nonprice aspects of the product helps both profitability and growth
- *Market position* both absolute and relative market share helps profitability but not growth
- *Managing complexity* simplifying by the avoidance of proliferation in both products and customers
- *People* where talent “fits” stage of development so enterprise during growth and discipline during maturity

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- *Innovation/differentiation* moderate innovation is best for profit; high innovation for growth
- *Customer power* avoidance of buyer power where immediate customers buy large amounts
- *Growth of served market* being in a growth market helps profit and growth but can drain cash flow
- *Vertical integration* impacts favorably in mature markets but not so good in growing markets

This “scientific” approach to business strategy seems to have stood the test of time. First, these findings are consistent with those of Schoeffler’s original work in GE. Second, despite the business cycles over the last 40 years, the increase in the number of businesses in the database (from 1970 to 1983 = 2600 SBUs; 2011 = 3811 SBUs) and changes in the metrics, types of businesses and geographical coverage, the coefficients remain stable:

The PIMS findings have stood up through all this diversity and through the information revolution. In general, even the coefficients have not changed: a doubling of relative market share is worth the same amount of ROI or ROS in the 1970s, the 1980s, the 1990s and the 2000s. Some factors reflecting technical progress (e.g., capital and labour productivity) have improved steadily, of course, but the profit benefit has generally gone to the customer.

Roberts, 2011; p. 2.

CRITICISM

Scientific approaches to social science enterprises (e.g., business firms) and activities (e.g., strategy formulation and implementation) will attract criticism and the PIMS approach is no exception. Besides the sample bias to larger businesses and the general limitation of cross-sectional studies, it has faced specific attacks on its methodology (Rumelt and Wesley, 1982); its neglect of crucial influential variables (Anderson and Paine, 1978); its proffering of “universal laws” (Abell and Hammond, 1979) (Woo, 1984); the presence of multicollinearity among the explanatory variables (Almanza and Tomas, 2011); its manifestation in simulation games

(Dickinson, 2006); its definition of the market (Farris and Farley, 2004); and its spurious statistical assumptions (Jacobson and Aaker, 1985). But PIMS’ best known “law”, that is, the market share–profitability link (*see* MARKET SHARE) has been the magnet for both perennial paper production (48 empirical studies and 276 estimates of profit–market elasticities according to Szymanski *et al.*, 1993) and much scorn. The most serious has come from Jacobson (1988, 1990) and Jacobson and Aaker (1985), whose contention is that the association between market share and ROI in the PIMS study is spurious because both are influenced by intervening variables such as luck or managerial skill. By 1990, Jacobson had gone further by suggesting that none of the variables in the PIMS “PAR ROI” model had any significant influence on profitability and claimed that unobservable, intrafirm factors were responsible for business performance. These claims have been countered by one of the original researchers (Buzzell, 2004) who suggests that Jacobson’s findings are the result of “his analysis dealing with year to year changes in ROI for a given business unit, not differences among business units” (p. 480). A further PIMS study (Hildebrandt and Buzzell, 1991) using structural equation modeling (not available to the original researchers) finds that, over a 6-year period, increases in market share led to improvements in key cost components and in productivity which, in turn, affect profitability.

In retrospect, I find it difficult to understand the vehemence with which our findings about market share and profitability were attacked. One possible reason was that our early findings were published at a time when a leading consulting firm, the BCG, was advocating aggressive share building strategies. It seemed to us at the outset, and it still seems to me today, that there is a straightforward explanation for a positive association between market share and profitability, namely, economies of scale³.

Buzzell, 2004; p. 480.

FUTURE

PIMS success, as measured by papers published (over 108 by 2004), began to tail off in the mid-1990s. It ceased trading in North America

in 1993, though its European arm continued to flourish from London after that. It fed academic research in marketing and strategic management for two decades and established some fundamental generalizations about the main influencers on profitability such as market share and product quality and their perceived robustness over time. Indeed, it accomplished most of this at a time when IT capacity was in its infancy regarding software and computer modeling power. Advances in modeling will tease out many methodological inconsistencies and help specify relationship with greater clarity and solidity. Furthermore, through the SPI, senior multinational executives, such as Jack Welch of GE, were influenced by the findings around SBUs and “total quality management” as a result of the PIMS project. So it has been impactful across a number of fronts.

However, incautious allegiance to the “laws” suggested by PIMS is likely to lead to futile results as the quantitative “science” of PIMS is only one side of the strategy coin. It is more Ansoff than Mintzberg⁴, in the sense that the underlying assumption is that the numbers dominate the formulation and implementation of strategy. Qualitative approaches to strategy emphasize learning, knowledge, enterprise, culture, spirit, adaptability, and resilience. These issues are tough to capture in both data collection, as they rely on subjective judgments, and structural equation models, without the extensive use of dummy variables. Strategy might be just as effective without design (Chia and Holt, 2011) or, moreover, in combination with it.

ENDNOTES

¹ By 1975, the program was adopted by the Strategic Planning Institute (SPI).

² Two contextual issues created an unprecedented challenge to the team. First, this was a data-rich project in the days before easy access to multivariate statistical packages. Hence, the early analysis was cumbersome by modern standards. Second, there was no prior body of theory or knowledge on this new “scientific” (or normative) approach to business analysis.

³ Ironically, the founder of the BCG, Bruce Henderson, claimed to have “discovered” the

experience curve that underpins Buzzell’s argument here.

⁴ A major debate flourished in the strategy literature in the 1980s between Igor Ansoff and Henry Mintzberg over the nature of strategy as design or learning.

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