

Market Share as a Firm Driver: Important Strategic Implications from Reviewing Literature from 1974-1995

Khalid A. Almurshidee

Department of Business Administration, College of Economics & Management, Qassim
university, Buraydah 52571, Saudi Arabia. Email: k.almurshidee@qu.edu.sa

Received: December 1, 2023 Accepted: March 30, 2024 Published: April 4, 2024

doi:10.5296/bms.v15i1.21499 URL: <https://doi.org/10.5296/bms.v15i1.21499>

Abstract

The important strategic implications of market share were and still needed to be clearly understood. In particular, the relationship between market share and profitability have not been settled in business literature until the mid-ninety of last century. Researchers were able clarify this relationship mainly because of The possibilities it provided by PIMS data. This paper reviews the main literature on the different aspects and concepts of market share and its strategic implications from 1974-1995; the period in which this topic was in its peak; which is in return has yielded the most important academic thoughts and inferences to the subject of strategic planning. The most notable one is with regard to the conclusion that market share caused profitability has been proven to be overly simplistic.

Keywords: market share, quality, efficiency, profitability, market power, strategy, economics of scale

1. Introduction

Over the years, more attention has been paid to market share than any other marketing variable. That interest results from a long history of research that shows that higher share leads to higher profits. Market share was in many respects the most important strategic indicator of competitive strength. However, the link between market share and profitability might be not all that clear according to many other marketing and strategic planning's researchers. For instance, criticism has increased against the presumed causal relationship between a business's market share and its profitability. This paper aims to present a "precise" review of the key literature contributions on the main aspects and concepts of market share

and its strategic implications from 1974-1995; the period in which this topic was in its peak. This period, in particular, has yielded the most important academic thoughts and inferences to the subject of strategic planning (e.g.; Bhattacharya et al., 2021). Thus such precise review should be of high interest for both researchers and practitioners.

2. PIMS and Market Share Analysis

In the beginning of the formal strategic planning discipline, arguments about the central importance of market share were based largely on the logic of economic analysis (Buzzell & Gale 1987). There was little empirical support for the notion that higher market share would lead to higher return on investment. That was to change with coming of the PIMS project at General Electric Company (Ramanujam & Venkatraman 1984; Marshall & Buzzell 1990).

The PIMS (profit impact of marketing strategy) project grew directly out of the corporate strategic planning department at GE. The PIMS project started in 1960. After the McKinsey & Company consulting project had been completed in 1969, the company recognized itself around 43 SBUs, a sharp reduction from 190 separate business plans that the CEO had had to review under the old organization. These 43 SBUs, each of which might contain several businesses, covered 23 of the 26 two-digit SIC (Standard Industrial Classification) codes used by the Bureau of the Census. GE was a highly diversified company competing in virtually every industry imaginable (Buzzell & Gale 1987; Ramanujam & Venkatraman 1984; Marshall & Buzzell 1990; Markides 1995). GE management recognized that this breadth of experience offered a natural laboratory for examining the fundamental determinants of competitive strength and business performance. To follow up on this possibility, the PIMS program of research was launched in 1972. Later, the PIMS would become an independent institution known as Strategic Planning Institute (SPI), eventually attaining a database of more than 450 companies and 3,000 business units (Buzzell and Gale 1987; Ramanujam & Venkatraman 1984; Marshall & Buzzell 1990; Markides 1995). The PIMS study main purpose was to gather real data on different measures of business performance for more than 2,000 business units. Eventually, the PIMS database has contained five years cross-sectional data on 150 performance variables (e.g., Boyd 1995; Marshall & Buzzell 1990).

The PIMS database contains relevant cross-sectional data on a variety of environmental, strategic, and performance variables that have been found to be generally valid and reliable (Jacobson & Aaker 1987; Marshall & Buzzell 1990). The PIMS project and its associated research address generally the relationships between market structure, market strategies, and business performance (Jacobson & Aaker 1987; Ramanujam and Venkatraman 1984; Marshall & Buzzell 1990; Clarke & Grilliches 1983).

A committee of executives from marketing, finance, manufacturing, and research and development complete the PIMS data forms. The companies pay a minimum of \$35,000 to have their data analyzed, with the typical company paying many times that figure over the course of its involvement with PIMS. Approximately 150 manager-hours are needed to fill

out the initial data forms. Before all of the consulting activities are completed, managers will spend several hundred additional hours dealing with the results of these data (Ramanujam & Venkatraman 1984; Marshall & Buzzell 1990). Thus, the executives have an incentive both to report their expectations truthfully and to calculate realistic expectations if theirs are initially unknown (Ramanujam & Venkatraman 1984; Marshall & Buzzell 1990). The Strategic Planning Institute processes all of the data on market structure; competitors, financial structure, and so forth, which are submitted by the executives and gives advice concerning appropriate corporate strategies (e.g., companies in your position should advertise less, invest more, etc.). The advice is strongly dependent on the forecasts of future market developments (Clarke and Grilliches 1983; Hambrick & MacMillan 1984; Ramanujam & Venkatraman 1984; Marshall & Buzzell 1990).

3. The Important of Market Share to Profitability

As mentioned before, the basic methodology of PIMS project was regression analysis, a form of correlation analysis in which n variables are arranged in an $n \times n$ matrix and the correlation of every pair of variables is determined. Equations are then built to combine variables in terms of the strength of their association with the dependent variable, that variable the analyst is interested in explaining and predicting. In the PIMS analysis, the dependent variable was profitability, measured as return in investment. There were 36 other independent variables in the database that could be examined for their influence on the profitability of a business (Buzzell & Gale 1987; Ramanujam & Venkatraman 1984; Marshall & Buzzell 1990). Among all variables examined, it was market share that had the strongest association with return on investment (Schoeffler et al., 1974; Buzzell et al., 1975; Boyd 1995). According to Buzzell and Gale (1987), this finding was entirely consistent with the theory and conjecture of the strategic planning school and gave new life to the belief in the strategic importance of market share. Efficiency theory predicts that business with large market shares are cost-efficient because of experience curve and scale effects that ultimately lead to greater profitability (Day & Montgomery 1983; Buzzell & Gale 1987). Market power theory posits that businesses with large market shares have the power to obtain inputs at lower costs, extract concessions from channel members, and set prices rather than be price takers to increase their profits (Peters & Austin 1985; Buzzell & Gale 1987).

To put these results into perspective, it is helpful to understand a bit more about the PIMS database, especially because the critics of the PIMS findings often focus their attention on the quality of the data. Among the variables in the PIMS database, in addition to market share, were such things as advertising expenditures, product quality, stage in product life cycle, type of business (service, durable goods, etc), frequency of product changes, rate of technology change, type of and number of customers, average size of purchase, and several items taken from a profit and loss statements or balance sheet (sales, percentage of revenue spent on purchases, R&D expenditures, fixed assets, profit, etc.). The data provided by the managers of the business as answers to a series of questions, product quality and price were assessed relative to competition (Buzzell & Gale 1987; Ramanujam

& Venkatraman 1984; Marshall & Buzzell 1990; Markides 1995).

The findings on the effects of market share was subsequently duplicated and expanded by many PIMS researchers. The result, however, was vigorous. Many studies confirmed the positive relationship of profitability (ROI) and market share (Buzzell, Gale, and Sultan 1975; Buzzell & Wiersema 1981; Macmillan et al., 1982; Capon, Farley & Hoening 1990).

One of the most famous results from PIMS database was that reported by Bob Buzzell, Brad Gale and Ralph Sultan in Harvard Business Review in 1975 under the title "Market Share: A Key to Profitability". They reported a positive relationship between ROI and market share on a cross-sectional basis within the PIMS database. Also, a 10-point increase in share of market was found to be associated, on average, with a five-point increase in return on investment. They indicated that a firm with a higher market share achieves a higher profit margin, lower costs to sales ratio, higher quality and higher flexibility in setting higher prices for its product.

Smirlock (1985) performed an analysis of financial statement data from 2,700 banks located in states which limited branch offices to the county in which the main office was located. As a result, the markets were clearly defined by geographical boundaries, without overlap. Banks in each market competed directly with one another for the loan and deposit business of a clearly defined group of individuals and businesses. In a regression analysis of market share, market concentration, and other measures, he discovered a strong positive relationship between market share and profitability.

It requires to be mentioned, however, that not all of PIMS studies on the market share have reported a strong and positive relationship between market share and profitability (see **Table 1**). For example, Bourantas and Mandes (1987) criticized prior studies for treating market share as an independent variable and profitability as a dependent variable. They saw both as dependent variables affected by intermediate variables such as product characteristics, promotion and distribution, price, and cost. These factors in turn were affected by independent variables such as resources and competencies, the firm's system of objectives, and business strategies.

Table 1. Prior Studies on the Market Share – Profitability Relationship

STUDY	YEAR	MS/PROFITABILITY RELATIONSHIP
Buzzell, Gale and Sultan	1975	Strongly positive
Macmillan, Hambrick and Day	1982	Strongly positive
Newton	1983	Weakly positive
Hergert	1984	Positive but insignificant
Smirlock	1985	Strongly positive
Wernerfelt	1986	Positive only in introduction/growth stages
Bourantas and Mandes	1987	Spurious relationship
Markell, Neely and Strickland	1988	Significant only in plastic sector
Jacobson	1988	No relationship
Schwalbach	1991	No relationship

Such studies also, provided reasons for the positive correlation between market share and return on investment (ROI). In general, three main reasons have provided by many PIMS researchers (Buzzell et al., 1975; Buzzell & Wiersema 1981; Buzzell & Gale 1987; Capon et al., 1990) for why a market leader with higher market shares is more profitable than those with smaller market shares:

Economics of scale: businesses with large market shares are cost-efficient because of experience curve and scale effects that ultimately lead to greater profitability (Day & Montgomery 1983; Buzzell & Gale 1987). Thus, large-share businesses are likely to achieved economies of scale in most cost components such as marketing, manufacturing, and R&D costs (Buzzell & Gale 1987). In fact, the early PIMS findings about the correlation between market share and profitability, when analyzed further showed that the major factor explaining the relationship was the ratio of purchases to sales. The firm with the largest market share seemed better able to achieve economies of scale in its purchasing expenditures (Buzzell & Gale 1987).

Market power: businesses with large market shares have the power to obtain inputs at lower

costs, extract concessions from channel members, and set prices rather than be price takers to increase their profits; which provide them with more ability to realize higher prices for their products (Peters & Austin 1985; Buzzell & Gale 1987). Moreover, When firms have a high market share within the market they serve, which typically results from a strong relative advantage in this market segment, they are expected to react toward the threats of the competition more quickly and intensely than those with smaller market shares, because this high market share is due to and results in this business being of strategic importance. Therefore, firms that have a vested interest in maintaining the sales of their present successful product should defend their position strongly by responding quickly and effectively (Phillips et al., 1983).

Quality factors: quality effects on market share/ profitability relationship have received much attention by many PIMS researchers (e. g.; Phillips, Chang, & Buzzell 1983; Jacobson & Aaker 1985). The argument however, is that firms achieve higher market shares as a results of quality factors. These factors include both management and product or services quality factors (Buzzell & Gale 1987). Thus, market share association with profitability itself reflects the firm's ability to develop distinctive products for related target markets (Buzzell & Gale 1986). However, the equality issue, du to its importance effect on market share/profitability relationship, will be analyzed with more details within the next sections.

4. How Significant Is Market Share?

The issue of the significance of market share has been debated among researchers since the initial work on the PIMS data by Buzzell et al., (1975). Most of this debate has been around the so-called “spurious correlation” or “third factor issue”. The debate centered around finding other factors affecting or moderating the relationship between market share profitability, which subsequently required using more complex statistical examination. Some studies suggested existence of third factor; and Thus, the correlation between profitability (ROI) and market share does not imply causality (Rumelt & Wensley 1981; Aaker & Jacobsen 1985).

However, other critics still question the extent of the traditional view of the presumed strong association between market share and profitability that had been dominated strategic management thought for many years. Some researchers have presented evidence that companies with small market share can experience relatively high rates of return (Hamermesh et al., 1987; Woo & Cooper 1983). Others have proposed that relationships between market share and returns is indirect at best, because both are jointly determined by other marketing variables such as product quality, product and industry life cycles, relative prices charged, marketing-related expenditures, or even luck or fate (Jacobson & Aaker 1985). Still other researchers have proposed that any causal relationship is actually the opposite of the traditional view; that profits drive market share, not vice versa (e.g., Anterasian & Phillips 1988). At the very least, these researchers suggest, the relationship is two way. These numerous exceptions to the traditional market share rule have led some investigators to

conclude that market share should not be considered as a firm strategic driver by itself. In fact, Robert Jacobson and David Aaker (1985) suggested that a “decline in market share may actually be an indication of good management” (p. 18). Also, Kevin Clancy and Robert Shulman (1994) stated “Today, planners are not so sure about any thing concerning market share and profitability. There is no disagreement that it is positive, but there is plenty of debate concerning the magnitude of the relationship and what it means” (p. 29).

Moreover, it has been another criticism around the validity of the generalization of the significance of market share that based on PIMS studies. As mention before, the PIMS data base contains information from approximately 400 large (mostly Fortune 1,000) North American companies. The actual unit of observation is a strategic business unit, typically an operating division. Thus, it causes a bias in the estimation of market share (Scherer 1980; Buzzell 1981; Day 1986).

5. Market Share Strategies

5.1 Experience Curve Approach: Reducing Price to Improve Market Share

A possible interpretation of the findings of the strong association between market share and return on investment is to conclude that the firm increases its market share will increase its profitability. Thus, higher market share will move the firm down the experience curve faster than its competitors and that a dominant market share will provide the low-cost position and resulting competitive strength (e. g.; Phillips et al., 1983; Buzzell & Gale 1987). One way to improve or increase the market share of the firm is to lower its prices. This interpretation of market share findings could lead to a “high-volume/low-cost strategy,” or “the experience curve approach” (e. g.; Phillips, Chang, & Buzzell 1983; Aaker & Jacobsen 1985; Buzzell and Gale 1986; 1987) this combination of high volume and low cost could supposedly lead to higher return on investment. This strategy was advocated by BCG and others who were impressed by the strength of experience curve effects (Phillips et al., 1983; Buzzell & Gale 1986; 1987). The problem is that the combination of low price and resulting low margins makes it difficult to earn above-average returns on large investment necessary to support the high volume strategy, especially if high cost debt is used to finance the volume/growth strategy (Phillips et al., 1983). Moreover, such strategy can also lead to disaster if the company puts its price cutting ahead of its cost cutting, anticipating that greater volume will produce the necessary cost improvement (Buzzell & Gale 1987). As Buzzell and Gale (1987) indicated, that there is nothing magical about the experience curve approach. Cost improvements do not come automatically with volume. Rather, they result from careful, programmatic attempts to reduce specific costs. Cost reduction must be managed (Buzzell & Gale 1987).

5.2 PIMS Approach: Improving Quality to Increase Market Share

Despite the fact that PIMS and BCG approaches agree on the direction of the relationship of market share and profitability (Aaker & Jacobsen 1985; Buzzell & Gale 1986; 1987),

suggested that the relationship between market share and profitability was more complicated. Market share did not influence profitability directly.

As mentioned before, some studies found many examples of small-share firms enjoying superior rates of return (Woo & Cooper 1982). Others found that both market share and return on investment tended to be jointly determined by other factors including product and management quality, marketing expenditures, luck, and unanticipated changes in the environment, such as entry or exit of a major competitor, a change in government regulations, or the introduction of new technology. Others found the suspected reverse causal link. In general, it was often found that the magnitude of the relationship between market share and return on investment was very small. Thus, many PIMS researchers (Jacobson & Aaker 1985; Jacobson & Aaker 1985; Buzzell & Gale 1986, 1987; Buzzell 1987) have obviously indicated that low margins, which would be characteristic of low-price competitors, were typically not associated with above-average return on investment, even for firms with dominant market share. Rather, it was a combination of high price and low cost that yielded superior profitability. According to many of these researchers, high price and low cost may or may not represent a contradiction because higher quality that associated with higher prices does not necessarily implies higher cost (e.g.; Jacobson & Aaker 1985; Buzzell & Gale 1986; 1987). This because customers are usually willing to pay more for a better, more differentiated product. Thus, it is not necessary that high quality leads to high cost. In fact, the reverse may be true. In many situations, "quality costs less" (e.g., Jacobson & Aaker 1985; Buzzell & Gale 1986, 1987; Buzzell 1987).

The common way to think about the relationship between quality and profitability is what has been called a "margin strategy" (Phillips et al., 1983; Aaker & Jacobsen 1985; Buzzell and Gale 1986, 1987; Buzzell 1987; Schaars 1991) as contrasted with the "high-volume/low cost strategy" or market dominance strategy. With a margin strategy, the company is typically pursuing one or more well-defined market niches, a set of customers with needs and wants that are served by the unique features and superior quality of a differentiated product. Furthermore, the margin strategy is often a market-niching strategy (Phillips et al., 1983; Aaker & Jacobsen 1985; Buzzell & Gale 1986, 1987; Buzzell 1987; Schaars 1991).

A well-known author in the strategy management era, Michael Porter (1980), offered some evidence in support of the notion that either a volume strategy or a margin strategy could produce superior results. He proposed that firms should choose which of the two strategic options they were pursuing and not to try to find some combination of the two. According to Porter, firms that were "stuck in the middle," with neither a superior quality/market niching strategy nor a dominant, low-cost market position had the lowest return on investment.

However, the assertion that low cost and high quality are mutually exclusive is debatable according to many researchers (Phillips et al., 1983; Aaker & Jacobsen 1985; Buzzell & Gale 1986, 1987; Buzzell 1987; Schaars 1991). According to Aaker and Jacobsen (1985), there is another way to think about the relationship between market share and profitability that is to

see both market share and low cost as driven by superior quality. If customers really value the superior quality supposedly being built into the product or service, the demand for it will be higher and it will command a relatively higher price. In this instance, what were called simply the "quality strategy," leads to both high volume and high margin, and volume, in turn, produces a favorable cost position. According to Buzzell (1987), further analysis of PIMS data has led the officer of the Strategic Planning Institute to move away from their focus on market share and toward an emphasis on product quality. He asserted that higher prices associated with higher product quality did not deter market penetration. Thus, quality had a positive effect on return on investment, not directly but indirectly, through its influence on market share, which yielded both higher volume and lower cost (Buzzell 1987). Also, Buzzell indicated that many of PIMS researchers, as a result of strong evidence against the experience effect on market share/profitability association, have attempted to disassociate the market share arguments from those based on experience curve effects, as advocated by Bruce Henderson and BCG, and to associated market share with quality.

5.3 Value-Delivery Strategy

One of the most interesting examinations of the relationship between market share and profitability was conducted by Cathy Anterasian and Lynn Phillips, in a study published by the Marketing Science Institute in 1988. They revisited the question of the direction of causality between share and profit and the role of product quality, using both PIMS and Federal Trade Commission (FTC) "Line of Business" data. What makes their study especially interesting is the model that they used to analyze the data, which they called "the value delivery theory of competitive advantage." Conceptually, it put the customer's definition of value back into the center of strategic focus (Boyd 1995). In their analysis of the PIMS and FTC data, Anterasian and Phillips could find no instance in which market share had a significant, positive, and temporarily prior influence on return on investment. In fact, they found stronger evidence of reverse causality; higher profit can lead to higher market share.

The central proposition of the value delivery theory is that sustainable competitive advantage has its roots in the ability of the firm to deliver superior value to customers at a profitable cost, not in the "structural barriers" to competition at the core of experience curve-based arguments (Anterasian & Philips 1988; Boyd 1995). According to Anterasian and Phillips, a business may realize on a particular set of skills in selecting, producing, delivering, or communicating superior value to a target market. These skills may reside in individuals, in technological capabilities, or in business systems designed and managed by the organization. In this sense, market share is the result of superior value delivery, as is profitability. Thus, market share and profit are caused by the same forces (Anterasian & Philips 1988; Boyd 1995).

Moreover, Anterasian and Philips factored the significant environmental discontinuities or "shocks" into their model in terms of their effect on customer's definition of value and the resulting change in the skills and resources that the firm needed to deliver superior value to customers at a profit. Thus, profitable firms had the management skills necessary to redefine

strategy to fit the new market requirements. Also, the more profitable firms were likely to have the skills and resources, necessary to create an opportunity out of these discontinuities or shocks to improve their market position.

In the same context, Day and Wensley (1988) proposed a new model for how the firm delivers superior value to customers. They offered a value proposition for balancing the analysis of customers, the company, and its competitors in a strategic planning framework. Their model is summarized in Figure 1**.

In the center of their model is superior customer value, seen as the major determinant of the firm's strength relative to competition. The other source of advantage is lower relative cost. Both of these are assessed relative to competitors. The positional advantages are based on the firm's distinctive competence, its superior skills and resources. According to Day and Wensley (1988), the firm's ability to turn its distinctive competencies into positional advantages depends on the quality of the strategy formulation skills of management. In formulating strategy, management must understand how customers define value, based on their needs, wants, and product use system and how they evaluate the firm's offering relative to those of competitors.

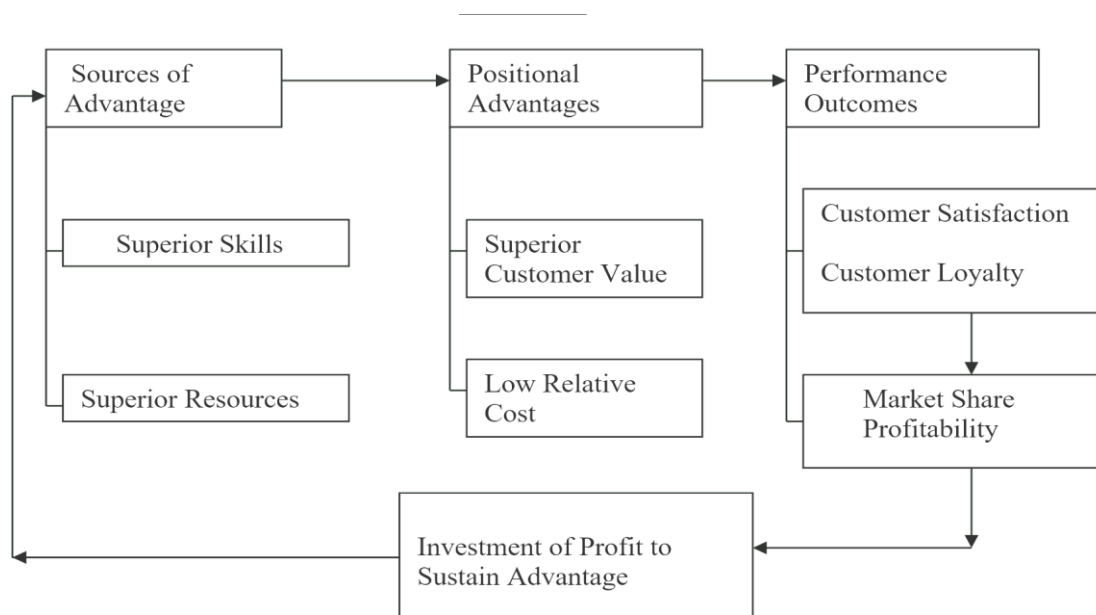


Figure 1. Proposed Model for Delivering a Superior Value to Customers **

** Source: George S. Day and Robin Wensley, "Assessing Advantage: A Framework for Diagnosing Competitive Superiority," *Journal of Marketing*, 52, 2 (April 1988), pp. 1-20.

Moreover, management must understand their competitors' business strategy, critical skills and resources, and value proposition. Thus, achieving positive performance results depend on managing the firm's positional advantages and implementing the strategy successfully (Day & Wensley 1988). In the value-delivery view of strategy, primarily customer satisfaction and

loyalty measure business performance. These lead to market share and profitability. According to the authors, this causal sequence is essential to understand the new viewpoint embodied in the value delivery view of strategy because market share and profits are the rewords of creating a satisfied customer; or the reflection of customer preferences or satisfaction (Day & Wensley 1988).

6. Conclusion Remarks

In inclusion and based on the literature review presented in this research, it is evident that product quality and value delivery have replaced market share and low cost as the key strategic variable (e.g.; Baker & Sinkula 2005). The value-driven concept of strategy has emerged out of reconsideration market share and its relationship to profitability (e.g.; Khantimirov 2017). The assumption that market share caused profitability proved to be overly simplistic. Rather quality as perceived by the customer has been identified as the critical force leading to both higher market share and lower cost, which combined to yield superior profitability. This requires emphasis on the central importance of product quality in determining market share. Superior business strategy based on product quality resulted in market shares. Simplistic thinking about the value of market share as a strategic objective in itself had been an extensive mistake for many firms (e.g.; Bhattacharya et al., 2021).

Acknowledgments

To all my colleagues in the College of Business & Economics at Qassim University who took the time to assisted me in conducting and critiquing my research manuscript.

Authors contributions

Not applicable.

Funding

Not applicable.

Competing interests

The author declare that he has no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

Informed consent

Obtained.

Ethics approval

The Publication Ethics Committee of the Macrothink Institute.

The journal's policies adhere to the Core Practices established by the Committee on Publication Ethics (COPE).

Provenance and peer review

Not commissioned; externally double-blind peer reviewed.

Data availability statement

The data that support the findings of this study are available on request from the corresponding author. The data are not publicly available due to privacy or ethical restrictions.

Data sharing statement

No additional data are available.

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