Imperial College Business School

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How can companies within the sports industry create a virtuous circle strategy?

by

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Executive Summary

Our problem statement is to assess ‘How can companies within the sports industry create a virtuous circle strategy?’

There have been an increasing number of references to virtuous circles within business strategy over recent years though there is a lack of consistency in the use of language and definitions. We research existing literature and then explore three sectors of the sports industry to identify where virtuous circles can be created.

We define a virtuous circle strategy as a series of steps which each causes the next, and eventually, closes the loop back to a previous step. These steps must result in a competitive advantage for the company as demonstrated by an increase in the gap between unit supplier cost and customer value. If this is true, then we can categorise within a 2x2 matrix which states whether it is customer value or unit cost that is affected (or both) and whether this occurs with annual volume (economies of scale) or cumulative volume (learning / experience effects). Finally, this positive impact would need to be repeated in subsequent time periods which we term the virtuous circle ‘spinning’.

Our review tests each cited example to assess the principle behind their idea. We then determine whether we agree that it meets the criteria outlined above. If so, we categorise it within our 2x2 matrix framework.

We conclude that there are four broad categories of virtuous circles, which are:

1. Network Effect Driven
2. Price Cut Driven
3. Product Enhancement Driven
4. Research and Development

We develop and introduce an engine analogy to illustrate the decreasing ‘purity’ of virtuous circles as we move down this list. All virtuous circles require an initial effort by way of investment, innovation or differentiation – i.e. an engine to get them running. We conclude that with a ‘pure’ virtuous circle such as that created with direct network effects, you could then turn the engine off and continue to enjoy the benefits of the circle spinning.

Price cut driven effects create a more virtuous circle where the impact of economies of scale within the sector is greater. Ryanair and Amazon provide two strong

examples where they ultimately revolutionise their industries through their creation of a virtuous circle.

Product enhancement effects covers a wide range of considerations from customer service, through technological / specification improvements to intangibles such as reputation. We conclude that the strongest reputational and experiential effects here can result in benefiting from direct network effects and the pure virtuous circles that they create.

Research and Development can result in a competitive advantage similar to product enhancement and this can be very significant if, for example, a technological breakthrough is achieved. By its nature, R&D is not always successful in delivering a positive outcome and even when it does, continued effort must be put in to see continued benefits – the engine must be kept running.

We selected three focus sectors of the sports industry based upon size and competition levels. We excluded professional sports teams, clubs and individuals and their associated sporting strategies to protect the validity of our conclusions on business strategy. Our sectors are:

- UK Gyms and Fitness Centres
- UK Sports Tourism
- Global Sportswear and Sport equipment manufacturers

As part of our research and analysis, we conducted highly targeted interviews which we used as case studies of ‘winning strategies’ within each sector.

We conclude that to create virtuous circles within the sports industry, companies should focus on product enhancement and specifically on building superior reputation and customer experience. The impact can be so strong that it results in direct network effects and therefore become pure examples of virtuous circles.

Companies within the sports industry can create these effects through developing a niche or specialism where their reputation for delivering a workout environment, sports tour experience or piece of equipment means their customers do not believe they can match this elsewhere.

Our research then has developed a fresh, formal definition of a virtuous circle within business strategy. We have also introduced a new conceptual analogy of an engine to kick start the virtuous circle and a new concept and method of categorising the purity of them.

Acknowledgements

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Contents

1 – Problem Definition and Approach

Our problem statement is to assess: How can companies within the sports industry create a virtuous circle strategy?

We developed this using a strategic problem-solving approach and problem statement worksheet (Lee, 2015) included as Appendix i.

1.1 - Purpose

There has been significant talk about virtuous circles in business strategy over recent years. These virtuous circles are where a chain of events positively reinforce themselves through a feedback loop such that success breeds further success.

The purpose of this project is to:

1. Investigate the nature of these virtuous circles.
2. Explore the extent to which virtuous circles are present in selected sectors of the sports industry (an industry of interest to the author) whether taken advantage of or latent.

1.2 - Approach

The approach that we will take to achieve the first objective is to:

- Define what we mean by a virtuous circle and establish a hypothesis that can be tested against.
- Establish what research has already been conducted on virtuous circle strategies.
- Carry out a literature review to identify and critically assess examples of putative virtuous circles in academic and popular business literature to establish whether we believe the examples actually involve virtuous circles.
- Review the examples and attempt to identify:
  - What are the underlying requirements for having a virtuous circle?
  - Do certain industry characteristics create the conditions for virtuous circle strategies?
  - Are there a small number of generic types of virtuous circle?

The approach that we will take to achieve the second objective is to:

- Analyse what kind of financial performance we see within our three selected sports industry sectors.
- Determine what strategies are being pursued by the leaders/winners.
- Explore where competitive advantages exist to explain why some players are more successful than others.
- Establish the key factors in achieving dominant position through the industry growth phase.
- Establish the extent of any virtuous circle strategies already occurring within the examined sectors.
- Establish if there is an opportunity for a virtuous circle strategy that has not yet been taken.
- Conduct targeted interviews focused on the identified virtuous circles within each sector of the Sports Industry.

1.3 - Language

Use of language is not uniform and a wide variety of terms are used to discuss concepts of strategy and phenomena such as virtuous circles. The framing of 'strategy' varies with authors discussing: strategy; business model; and business idea. Meanwhile, the major alternative terms used for 'virtuous circle' include: virtuous cycle; positive feedback loop; self-reinforcing; self-fulfilling; flywheel; and snowball effect. Our work focuses on the substantive differences between research findings rather than on the terminology used to express these differences.

2 – The Theory of Virtuous Circles

2.1 - Strategy

We start by being clear what we mean by business strategy and looking at the theory behind virtuous circles. This enables us to establish a definition and hypothesis that we can test against when assessing literature.

A strategy can be considered as a set of choices that a company makes relating to where and how it will compete. These should include:

- The type(s) of advantages sought over competitors.
- The scope of where to compete.
- Activities and policies that define how it will seek to achieve that advantage.

Strategists within any company are not only responsible for developing a strategy but also for assessing if it is possible to construct a set of logic for why the strategy has a reasonable chance of producing a competitive advantage for the company. This competitive advantage exists only if there is a wider gap than close competitors can achieve between customer value (customer willingness to pay) and unit supplier cost (supplier willingness to sell). The ability to capture this value is defined by the gap between realised price and actual unit cost (Fig. 1).

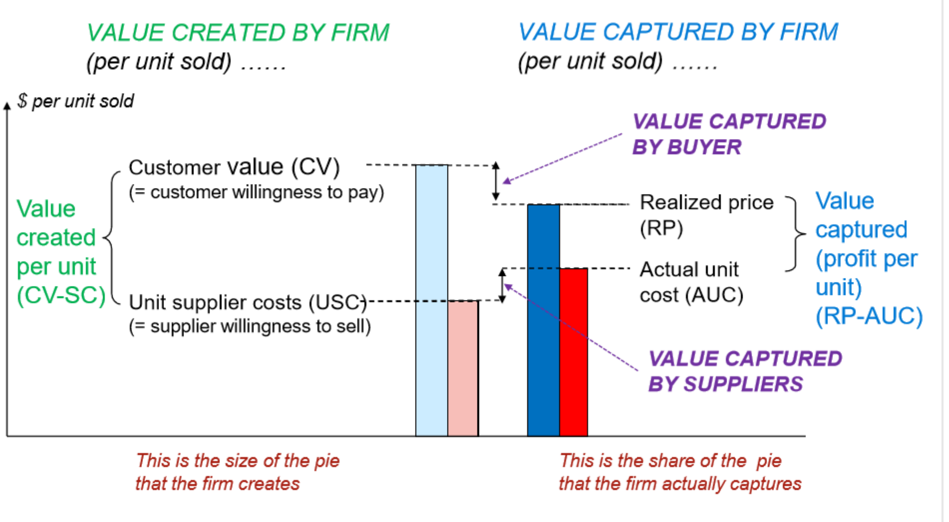


Figure 1 - Value Creation and Capture (Mackenzie, 2018)

This is the essence of the Choice – Value Framework (Mackenzie, 2018) which challenges whether our strategy choices will translate into sustained, superior profitability. If we can construct this logic, then it must be based on a good understanding of:

- The economics of the business, that is how customer value and unit cost behave in different circumstances.
- Our current competitive position including any distinctive resources or bargaining (dis)advantages relative to competitors.
- The strategies of competitors and substitutes.
- The intensity of rivalry.

This assessment is generally made now (T_N) and forecasting whether we will have superior profitability at some time in the future (T_F). Even with full consideration of relevant factors, this is a 'static' or 'steady state' projection.

Let's assume that we are in a position where we have made this assessment and we are satisfied that the company's strategy has a good chance of creating a competitive advantage at the target position, T_F. The question then becomes, how do we get from now (T_N) to future (T_F)? Given that there are likely different ways that could conceivably be employed to achieve this journey, we might legitimately think of these choices as being another aspect of the firm's strategy. Others may prefer to consider these as 'tactics' that sit alongside the strategy but that does not affect the substantive principle.

As this is about moving from one competitive position to another, much stronger, competitive position, we can consider these as 'dynamic' components of the company's strategy. It is logical to view these dynamic aspects as being about how we will dynamically build competitive advantage over a growth phase.

If we were dealing with a large well-established company in a mature market, there would be little need for this 'dynamic' strategy. It also follows that we should assume that we are dealing with the leader – the company who is ahead of the competition at the start – so that, other things being equal, they will arrive at the destination point (T_F) before other competitors (followers).

2.2 - Virtuous Circle Hypothesis

Our journey from T_N to T_F takes place over a finite number of time segments. Our starting hypothesis is that for a circle to be present, there must be two or more choices or steps which each cause the next step to occur and these consecutive steps must ultimately form a loop.

For this to be a virtuous circle, the company must be in a stronger competitive position, as measured by the gap between customer value and unit cost, at the end of the segment than at the start (Fig. 2)

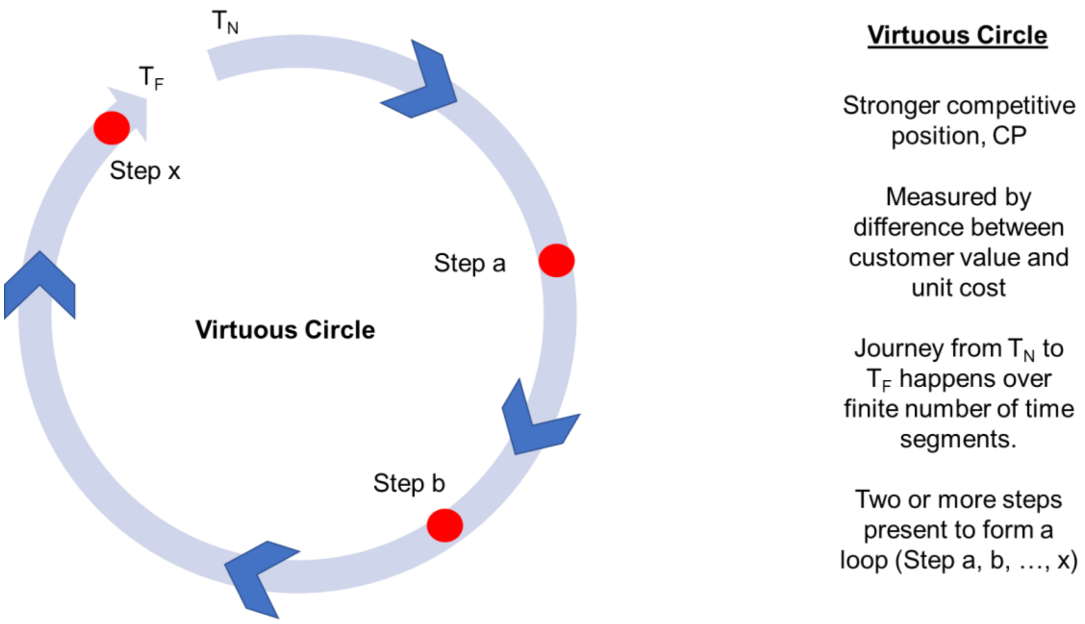


Figure 2 - Virtuous Circle Diagram

This can be true if customer value increases, or unit cost decreases, or both, given the increase of volume achieved over the time segment. We can demonstrate that this is the case if the relationship between customer value and volume is an upward sloping curve (positive correlation) or if the relationship between unit cost and volume is a downward sloping curve (negative correlation) (Fig.3).

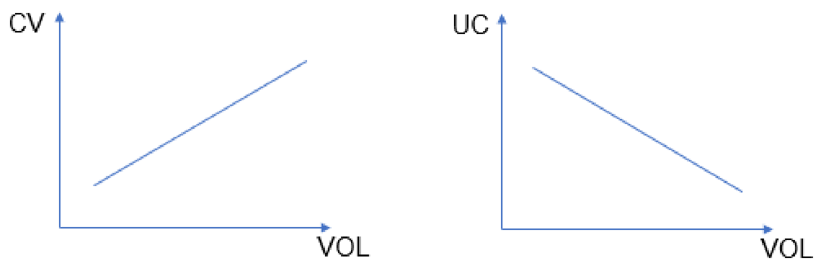


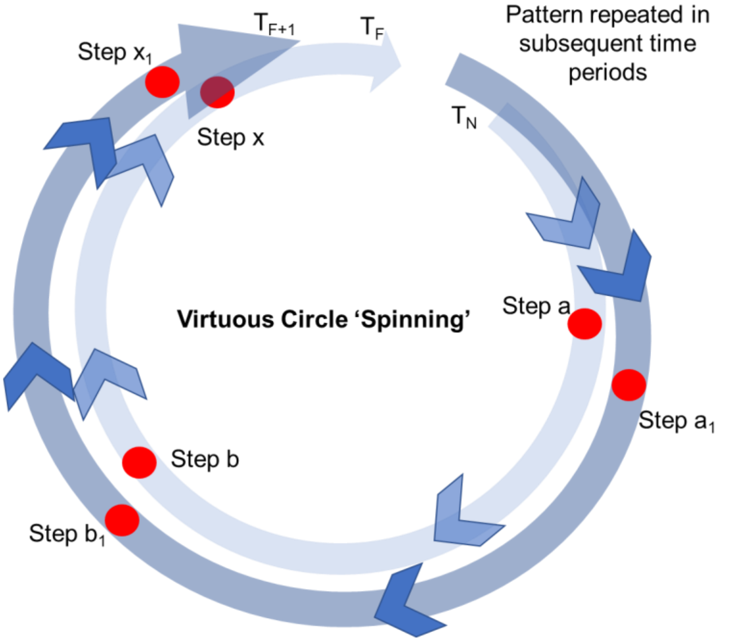
Figure 3 - Graphs of Customer Value and Unit Cost against Volume

It follows that where we can identify virtuous circles as we have defined them, we should be able to categorise them considering the following economic rules of the game. The customer value and / or unit cost must be benefitting from one or both of economies of scale (which depends upon annual volume) and learning effects (which depends on cumulative volume) (Fig. 4).

	Customer Value	**Unit Cost**
Economies of scale (dependent upon annual volume)	Demand side economies of scale (network effects)	Supply side economies of scale (typically caused by fixed cost spreading)
Learning effects / Experience effects (dependent upon cumulative volume)	Demand side learning effects (e.g. product or service enhancements)	Supply side learning effects (typically caused by increased productivity / efficiency)

Figure 4 - 2x2 Matrix

Finally, to be considered a virtuous circle, this pattern would need to be repeated in subsequent time segments (Fig. 5). This continuation is what we term as the virtuous circle 'spinning' and differentiates this from a single loop or chain of events with a one-off effect.



Virtuous Circle 'Spinning'

Moving to stronger competitive position CP in each time segment => Increasing value creation

$CP_F > CP_N$

$CP_{F+1} > CP_F$

Figure 5 - Virtuous Circle 'Spinning' Diagram

3 - Assessing the Literature

3.1 - Our Test

We conducted a literature review to understand what has already been written about virtuous circle strategies and what examples are cited. In critically assessing the examples, we apply a test against our starting hypothesis and therefore consider the following:

- What is the principle behind their example?
- Are there two or more steps that each cause the next and ultimately closes the loop?
- Do we accept that the dynamic aspects of the company's strategy which form the suggested virtuous circle result in an increase in the comparative gap between customer value and unit cost?
- Does it do so on a continuous basis over an extended growth phase, i.e. does the circle 'spin'?
- If so, where does it fit in our 2x2 matrix?

3.2 - Network Effect Driven

We begin assessing the literature by looking at examples where network effects are the primary factor in the proposed virtuous circles. We examine the range of network effects from direct, indirect and two or multi-sided networks.

3.2.1 - Direct Network Effect

High-technology sectors are a source of multiple references to virtuous circles and have been the primary sector to examine network effects since the telephone became the first mainstream example in the 1970s (Jorgenson, 2015).

We start by looking at Facebook who grew from public launch in 2006 to reaching 2.5 billion people or 1/3 of global population in 2019 (Facebook, 2019). The direct network effect here is clear as there is more value in being on Facebook when more of your friends and connections are also on there. There is little to miss if no one you know has joined but you don't want to miss out if everyone you know has joined. This increase in customer value addresses the criteria in our test and means we have a potential virtuous circle.

Facebook were not the first to enter the market. Friendster, My Space and Friends Reunited amongst others, were all launched to the public before Facebook. Timing, great public relations and learning from others' mistakes are credited as being the major factors that set Facebook apart (Press, 2018). Network effects can tip a market toward winner takes all where ultimately one player dominates and competitors fade away. Our focus is not to critique these factors but to acknowledge that it was essential to create an initial innovation and differentiation. On the back of this, from a given point, network effects essentially took over and Facebook's growth truly took off.

This direct network effect provides an example of a 'pure' virtuous circle in that once it is spinning, extra effort is not required to keep it spinning. Here, this means that the growth in users continues to attract more users without the need for new or additional initiatives. We introduce the analogy of an engine which here is the timing and great PR required to set Facebook apart. Thereafter, once the point is reached that direct network effects have begun, the engine can be 'switched off' and the momentum will see the growth continue. We can demonstrate this with a graph (Fig. 6) showing the exponential effect on customer value.

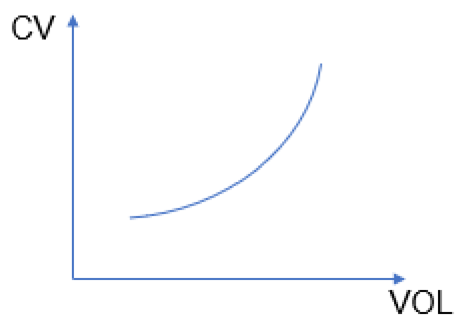


Figure 6 - Exponential Direct Network Effect on Customer Value

In terms of limiters to this virtuous circle, access to the required technology (hardware plus internet connection) has been and continues to limit the rate of growth of Facebook users. Eventually the cap is of course full market saturation of the global population. This would mark the end of the growth phase and with it the end of the virtuous circle.

3.2.2 - Indirect Network Effect

Facebook also benefit from indirect network effects. Burgelman and Siegel (2008) refer to the circle created between independent software developers and end users. They cite Apple’s historic failure to understand this regarding the PC industry though this is a lesson well learned by Apple with their iPhone range. Quite simply, as the number of users increases, the attractiveness to software developers increases as their potential market is growing. As the software functions and / or applications increase, they further increase the attractiveness for the end user. This is an indirect network effect where the software applications are complementary products for the hardware and operating system.

Applying our test, we look first at unit cost. Although these companies likely benefit from economies of scale as the customer base grows, this is not caused by an increase in the number of software developers. This factor is therefore discounted in terms of creation of a virtuous circle and so we examine customer value. Above we state that attractiveness for the customer (end users) grows as the number of developers increase. This is because the number of options and amount that you can do with your purchase of hardware and operating system grows as additional software is added. Customer value is therefore increasing and creating an advantage for the hardware developer. Intuitively we see that as the number of users increases, so does value for the software developers such that more will enter the market.

Finally, we are satisfied that the circle here will continue to spin unless / until no further increase in customer base is possible because full market saturation has been achieved. This point marks the change from a growth phase into a mature phase and, per our definition, naturally sees the virtuous circle come to an end.

The existence of these complementary products expands the size of the pie, but we note that they will also require their slice of the pie. This indirect network effect therefore does not create an entirely ‘pure’ virtuous circle because the extra value created is shared between hardware developer and software developers as well as end users.

To continue exploring this concept we look at Akamai, a content delivery network and cloud service provider. Akamai's then-CEO George Conrades (Carr, 2000) describes how he sees Akamai’s virtuous circle in his own words:

> ‘That's the virtuous circle: Better technology attracts more content. More content attracts more networks. More networks means better technology. And around we go.’ (p.4)

Their idea is that improvements in technology attracts increased content because individuals and companies find it easier to deliver an enhanced end-user experience. This in turn attracts more networks (ISPs) because having more of the popular content means hosting Akamai’s servers enables faster and cheaper content distribution for the networks. Finally, this results in the technology becoming more attractive to the content providers because Akamai are able to deliver their content to users at greater speed.

This concept has no impact on unit cost (for Akamai) and the existence of a virtuous circle is therefore dependent on a claim that customer value is continually increased. This is credible as Akamai’s customers are content providers who are repeatedly able to improve the experience for their own customers provided this circle continues and therefore the value to them is ever-increasing.

The circle remains intact until the market reaches some form of breaking point. In this case, that could theoretically be a pause in technological advances or, more likely, a saturation of the population of internet users meaning growth cannot continue.

This is another indirect network effect and, revisiting our hypothesis, we consider this an example of demand side economies of scale because as the ecosystem grows, the value to the customer increases. We have discussed this here as our assessment is that the network effect is the dominant factor. We acknowledge that technology improvements are also a factor and therefore this could have been considered in our later section on product enhancement driven effects.

We began this analysis from a live position in that there was already both content and networks. Once moving then, we can say that this is a virtuous circle. Here we have a situation where something else is required to establish a critical mass initially. This again is our ‘engine’ and acknowledges that it will likely require different strategy choices at the very early stage.

3.2.3 - Multi-sided Network Effects

This phenomenon can be seen elsewhere with examples including Apple and Uber, where two-sided or multi-sided platforms are created, and the resulting network effect forms a virtuous circle. For Apple we can see that a customer's willingness to pay (their customer value) will increase as the number of additional functions and applications on the iPhone increases. Equally we can see that an increase in the number and variety of taxis available will make Uber more desirable than competitor taxis.

3.3 - Price Cut Driven

In this section we review literature examples that feature driving low prices at the heart of their references to virtuous circles. This introduces some of the most frequently quoted examples of Ryanair and Amazon as well as less familiar examples. We are therefore looking for supporting evidence that unit cost can be driven down through the circles described.

3.3.1 - Ryanair

Ryanair are perhaps the single most used example to demonstrate the existence of virtuous circles. Casadesus-Masanell and Ricart (2010) identify Ryanair's three key virtuous circles*:

- Cycle 1: Low fares >> High volumes >> Greater bargaining power with suppliers >> Lower fixed costs >> Even lower fares
- Cycle 2: Low fares >> High volumes >> High aircraft utilization >> Low fixed cost per passenger >> Even lower fares
- Cycle 3: Low fares >> Expectations of low-quality service >> No meals offered >> Low variable costs >> Even lower fares

* Our preference would be for comparative terms which demonstrate a continuous loop. Therefore 'low fares' would be 'reduced prices' and 'high volumes and utilization' would be 'higher volume and utilization' (Fig. 7).

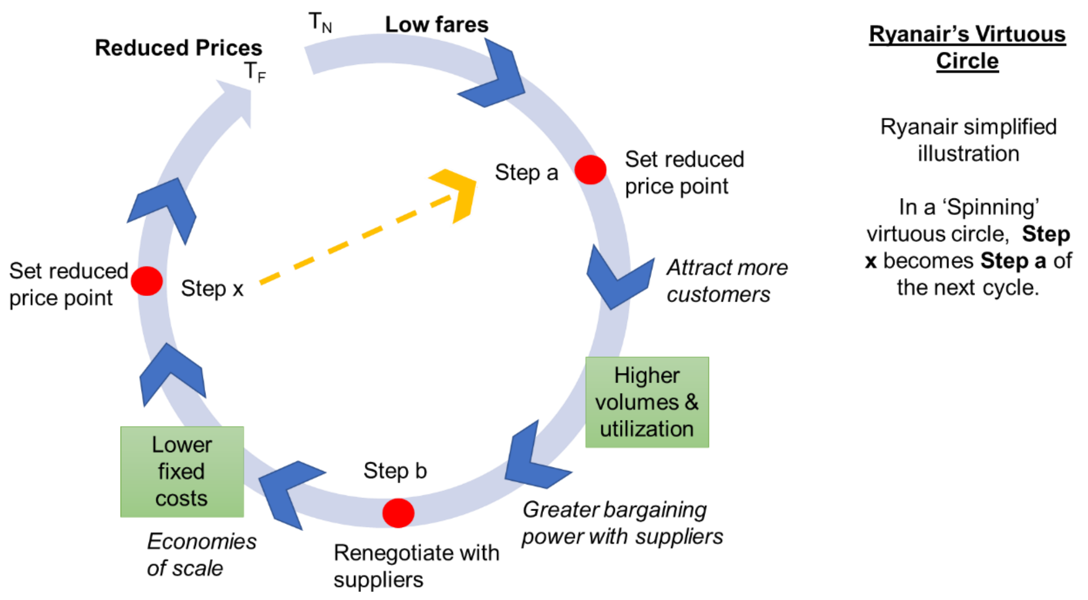


Figure 7 – Ryanair's Virtuous Circle

The idea here is that the actual unit cost is being driven down through a virtuous circle. We can see that the links as expressed make logical sense and do result in reduced actual unit costs, which enable reduced fares. The chains work as chains, but do the loops continue or spin?

To test this we examine the chains, on what would be their second loop. For cycle 1, as volumes continue to increase, can Ryanair continue to drive down their fixed costs through greater bargaining power? In the short term this is unlikely because Ryanair cannot renegotiate constantly with suppliers. In the long term this is possible though it would be limited as there is a floor to supplier prices below which they would never go for given volumes. We therefore start to see limits to the virtuous circle though we also have the question of volumes emerge and we return to this later.

For cycle 2, the high volumes leading to high aircraft utilization is logical but certainly limited and cannot continue indefinitely. Once planes are full and plane turnaround time is optimised, this cannot be a source of continued fixed cost reduction. We therefore cease to see unit cost reducing unless there is another way of reducing overhead costs.

For cycle 3, expectations and respective services can be minimised and taken to the (hypothetical?) extreme such as charging extra for use of toilets. Even at the extreme, there is again a limit beyond which this cycle ceases to spin and therefore no longer continues to deliver reducing unit cost. We can consider this as unbundling services to reduce unit cost which would have a one-off effect.

The existence of multiple chains creates a self-reinforcing nature across these business tactics even including cycle 3 which we consider the smallest impact of the examples. It also helps to show the importance of the complementarity of these chains as demonstrated by Airlines who have attempted to create a low-cost arm / subsidiary. United (Ted Airline), British Airways (Go Airline) and Continental (Continental Light) all failed to do so successfully because they compromised on one or more of these points.

We propose that there is an additional factor which wasn't expressed in the literature, but our examination exposes as very significant. That is the power of economies of scale as a dynamic effect, especially within this environment where we have self-reinforcing business tactics. Looking back at our cycles above, the proposed virtuous circle came to a halt for given volumes. At greater volumes, Ryanair would be able to continue to negotiate ever-reducing prices and keep that loop spinning. Equally for cycle 2, with each plane fully utilised, they can then add more planes and more routes. Doing so would have incremental increases in some overhead costs such as systems support or marketing costs meaning that the average unit costs would continue to drop and again the circle spins.

As we saw earlier, there is an initial push required here to get the engine running. Here this is an initial investment in low prices and in the infrastructure to create the environment described above. This may not be entirely pure, in that you perhaps can't entirely turn off the 'engine' but nor have others been able to catch up as Ryanair have been the most profitable of Europe's big five airlines every year since 2005 (Centre for Aviation, 2019).

3.3.2 - Amazon

Amazon's famous flywheel business model (Collins, 2019 and others) is reputed to contain multiple virtuous circles. The first that we examine is Amazon's ability to reduce unit cost. As the number of buyers increases, its distribution network becomes incrementally cheaper per product as efficiency increases through increased utilisation. This reduction remains relatively marginal and cannot continue indefinitely beyond the point where full, or optimal, utilisation is achieved. A more significant and continuous cost reduction can be demonstrated in the spreading of the fixed cost of building and maintaining a user-friendly online shopping interface.

Now benefitting from massive initial investment, this is a key competitive advantage for Amazon. It does not require anywhere near the same continued effort (investment) in order to continue to reap greater benefits and so points to a virtuous circle emerging from economies of scale.

The second key area is a continuation of the indirect network effect (discussed within High Technology) this time with buyers and sellers each increasing the attractiveness for the other as they use the platform. The concept is very similar, and we can reasonably say that the more sellers there are on the Amazon platform, this increases the customer value to Amazon customers because they have greater choice under one umbrella making it easier to find what they want. This is effectively a convenience factor which research supports as being secondary only to price (Gawor & Hoberg, 2019).

We can say therefore that Amazon do benefit from economies of scale on both supply side and demand side (indirect network effects). Drawing from our initial hypothesis we can identify how Amazon achieve a virtuous circle as we define it.

3.3.3 - Self-Organised Networks

Evans and Wolf (2005) illustrate a different angle on virtuous circles within 'self-organized networks'. Though this references networks, we include in this section as the principle idea is driving down prices through using self-organised networks. They identify this within very different examples, interestingly including Linux and Toyota. This adds to our earlier discussion of high-technology as well as auto manufacture which we discuss later. In their words, Evans and Wolf say:

> 'A dense, self-organizing network creates the conditions for large-scale trust. Large-scale trust drives down transaction costs. Low transaction costs, in turn, enable lots of small transactions, which create a cumulatively deepening, self-organized network. Once the system achieves critical mass, it feeds on itself.' (p.9)

The concept is that deep trust is facilitated through self-organised networks because there isn't a figurehead, system or structure to distrust. Furthermore, in such environments, where information is freely shared, reputation becomes a critical factor for all so people behave very much as desired to protect their reputation. This enhanced trust means that less resource is required for supervision, negotiation or conflict resolutions. This therefore reduces the cost of producing the service or good

– what they term ‘transaction costs’. These reduced ‘transaction costs’ provide the example our test needs of reducing unit costs. This in turn makes it profitable for companies to perform more and smaller transactions and with it the pace, flexibility and desirability of the company increases. Finally, this generates increased motivation and creates a ‘deepening, self-organized network’ which sees the loop close. Each step remains valid on subsequent loops around the circle and so again we can say that the virtuous circle spins. Evans and Wolf sum up the power of this trust-based, self-organised network in creating a virtuous circle across very different industries

> ‘The success of Linux is evidence of the power of that virtuous circle. Toyota's success is evidence that it is also powerful in conventional, profit-maximizing companies.’ (p.9)

The effect here for both Linux and Toyota is that costs are kept lower than for competitors as they grow. Though again, not a pure virtuous circle, our classification then is supply-side economies of scale.

3.4 - Product Enhancement Driven

In this section we examine literature references where customer value is driven up through an enhanced product or service. This covers a wide range of considerations from customer service, through technological / specification improvements to intangibles such as reputation.

3.4.1 - Customer Service / Employee Engagement

Multiple references to the creation or existence of virtuous circles focus on customer service or employee engagement. Generally, these references tend to suggest that a virtuous circle can be built around one or other of these (e.g. Temkin Group, 2010). Our approach prefers not to consider a circle being built around a single step though we recognise that customer service and employee engagement can often be found adjacent to one another on this type of virtuous circle.

The idea here is that engaged employees are more satisfied and motivated and therefore deliver a higher standard of customer care and service. This improved customer experience results in more loyal customers which in turn has both direct and indirect positive effects on employees. Knowing, and perhaps developing a reputation for, making customers happy makes employees ever prouder of working for the company. Also, the increased loyalty of customers will have positive financial impact on the company and enable greater incentives, rewards, development and general conditions for employees which can again increase satisfaction, motivation and engagement.

Logically this flows and is especially true in service industries where customer experience is most important. Here, the more engaged the employee, the better the service they are likely to provide and the more satisfied the customer will be with their service. Our interviews exploring sports tourism later strongly reinforce this, talking about “providing the richest of experiences, backed up by caring, experienced and knowledgeable staff” (Gardner, 16/11/19). They demonstrate an explicit intention to hire the right staff and then support and empower them such that they become a competitive advantage through the experience that they offer.

In applying our test, there is no unit cost reduction, so we are looking to examine customer value. It is reasonable to accept that customer value increases as the service / experience they have increases and herein lies the enhanced offering to the customer.

There is no automatic limitation within this cycle. Each step can continue to improve provided that some other factor or decision does not break the cycle. We conclude that this is a virtuous circle as per our definition. As we see customer value increase with cumulative volume, this is categorised as demand side learning effects.

As now expected, we observe that this requires more initial effort in order to establish this superior service. Investment and dedication to create the conditions and environment where employee engagement excels is then rewarded with reducing requirement to continue investment. Our engine can’t quite be switched off but, whilst only idling will continue to reap the benefits.

3.4.2 - Corporate Social Responsibility / Corporate Social Performance

There have been several studies (Makni, Francoeur, & Bellavance, 2009; Nelling & Webb, 2009 and others) claiming to show that a virtuous circle exists between corporate social responsibility / performance (CSR / CSP) and financial performance.

Individual studies focus on specific subsets or on different proxies for CSR/CSP and financial performance. The common underlying basis of these is that there is a two-way causality between financial performance and CSR/CSP. That is to say that increased financial performance leads to greater firm investment in CSR activities and vice-versa.

To meet our criteria for a virtuous circle, we would need to accept that greater CSR activities increases customer value because customers see the wider benefit that is derived from their purchase of the given product / service. Orlitzky et al. (2003) conducted a meta-analysis which concludes that there is positive correlation, and this can be demonstrated through companies such as Patagonia and Toms who have built and boosted product differentiation on the back of their social responsibility practices. What we have here are two examples of companies investing through accepting increased overall unit supplier costs. They do so on the basis that the resulting increase in customer value more than compensates for that cost increase and therefore the gap between cost and value will increase. This increase in customer value can be justified as enhanced enjoyment of a product achieved through knowing that your purchase achieved a net positive impact on wider society. It can also be explained as simply enhanced enjoyment (value) of the purchase from the reputational of the company. We explore this reputation aspect at greater depth within our sports industry analysis.

Though we have these examples, applying causation as a rule does not stand up to scrutiny across the board. Scholtens (2008) concludes that there is 'evidence that the direction of the 'causation' predominantly runs from financial to social performance' (p.1) and we agree that there is not a ubiquitous phenomenon here.

Our conclusion here is that specific companies, like Patagonia and Toms, can create a virtuous circle based on product differentiation, reputation or some other unique characteristic but we do not support the claim that CSR and financial performance creates a widespread virtuous circle.

3.4.3 - Auto manufacture

Grover & John (2015) discuss an automaker creating a virtuous cycle with their sales strategy through what they term 'a cascading approach to sales'. This model can be thought of simply as maximising the value that you can extract from leasing cars (or other comparable equipment) through leasing out to a second customer with slightly lower spec needs once the first customer returns it and continuing. Alone, this doesn't begin to meet our criteria for a virtuous circle as there aren't multiple steps which each cause the next stage in a loop. Another framing has more potential to do so and Grover & John also reference additional considerations and steps than their sales strategy when they say:

> ‘They are realizing that they're no longer just in the business of selling new vehicles and equipment. As they establish a virtuous cycle, they are instead maximizing economic value over the lives of the assets they sell.’ (P. 11)

This concept looks at their wider business model and therefore products and services that weren’t previously considered core. To test, we start with their stated fact that their resale value was approximately 10% higher than competitors. It is reasonable to assume that, all else remaining equal, this would increase customer value and result in higher sales. Grover and John suggest that this results in improved dealer alignment and incentives because they can achieve higher margins (Fig. 8). Achieving greater margins in this case requires that prices are higher than competitors.

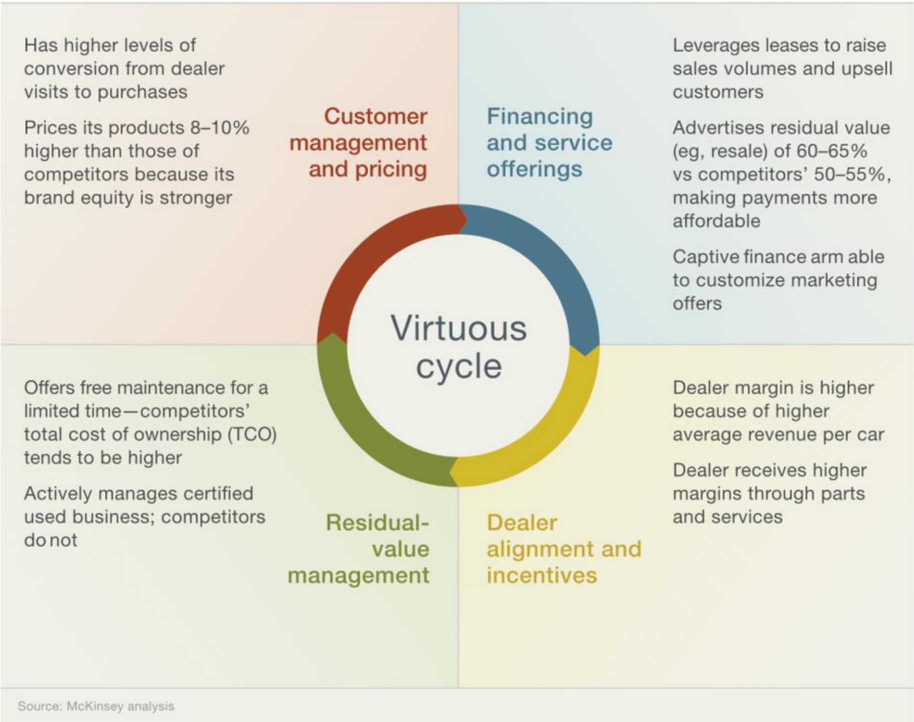


Figure 8 - Virtuous Cycle (Grover & John, 2015)

As always, we come back to the value created by the firm i.e. the gap between unit supplier costs and customer value. We accept that customer value has increased because the residual / resale value has increased. We are also stating that unit supplier costs have increased in order to enable greater incentives. Whilst it is very possible for this combination to result in an increase in overall value creation, we don't have the evidence to prove that this will be the case here. Therefore, whilst we won't write this off as a potential virtuous circle, we note it is less 'pure' than some earlier examples.

Continuing our test, the next step is that these increased margins enable improved maintenance and servicing packages which keeps total cost of ownership down compared to competitors. Higher resale value and lower maintenance costs could result in lower total cost of ownership even though the initial purchase price is higher. This is plausible then although we must acknowledge that if so, profit margins would clearly be reduced through this tactic. This 'residual value management' is then said to result in higher conversion levels of customers visiting dealers which is a reasonable outcome if we have accepted the lower total cost. The closing of the loop then brings us back round to leveraging the 10% higher resale value. We cannot support the argument that there is a causal factor here but, more crucially, there is no continued increase in customer value which would enable us to follow the loop round again.

It is clear that the steps outlined complement each other and it is very possible to see how they could come together to produce a competitive advantage. Our test criteria however, raised several limitations which leads us to conclude that this does not spin and is a much weaker (less pure) example of a virtuous circle.

In his review of Sydow & Schreyögg, Narduzzo (2014) also talks about self-reinforcing mechanisms and uses the example of innovation in the car industry. He describes the 'complementarity effect' where the availability and development of one product has a significant impact on the value of the complementary product provided that no resultant bottleneck is created. We can intuitively see that this is true as it essentially describes what we know about complementary products. The extent to which this could potentially describe a virtuous circle however, is limited as the products would need to be reciprocally complementary and increasingly so. We conclude that where this is plausible, it would fall under previously discussed section on network effects and so we do not consider this a viable virtuous circle.

3.4.4 - Google

We have so far seen three of the five FAANG companies and here we examine Google. According to Sterling (2008), Google benefit from a virtuous circle through being able to 'show fewer ads and still make more money'. The idea stems from an intricate set of measures which Google introduced to determine the quality of an advert and in turn the price that must be paid to achieve a prominent placement for the advert. We can see how this incentivises advertisers to improve their ad quality and how in turn this benefits Google users and creates increasing customer value.

Ultimately Google's success was built on being the best search function (Heitzman, 2017). This was a strong case of product enhancement which prioritised the quality of the results from the users' perspective over the value of the fees paid by advertisers.

This series of steps created a very strong competitive position for Google and undoubtedly this was eventually supported by both direct and indirect network effects. This position was further significantly supported through data gathering and utilisation and we move on to examine data usage next. Strictly then, we don't accept this reference as a virtuous circle per our definition.

3.4.5 - Data

We have discussed various companies who benefit from economies of scale and clearly there is a self-reinforcing component that is due to the size of these companies. There appears to be a further, very significant, consideration in their data utilisation that we have not yet examined.

Voytek (2016) discusses the data ecosystem and how increased data capture and analysis can result in unprecedented knowledge discovery. He concludes that this 'can create a virtuous cycle that allows researchers to remix and reanalyze data in new and interesting ways' (p.4). Löfström and Odqvist (2004) discuss 'the virtuous circle of data mining' and the benefits of 'the process of transforming data into actionable information' (p.8).

These and other references have different points of emphasis, but the overarching idea is that the use of data can create a virtuous circle. Step one is that better data enables faster, more focused product / service innovation which then results in better products or services. We are satisfied that this claim is justified as better understanding of customer needs, wants and usages should enable new or enhanced offerings. It is therefore also reasonable to assume that these enhanced products / services will increase customer value as they better address customer desires.

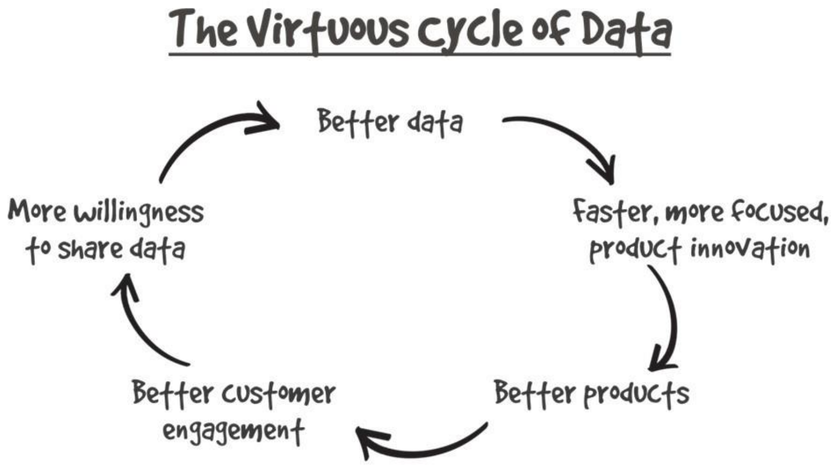


Figure 9 - The Virtuous Cycle of Data (Somasegar & Li, 2018)

So, it is claimed that better products result in better customer engagement and therefore to increased willingness to share their data (Fig. 9). We can observe this pattern in action as people are inclined to feel more comfortable sharing their data with companies they feel an affinity towards. There are also examples where this willingness to share data can be introduced as a condition of use. This can be seen especially where there is vast power differential between supplier and user such as with the FAANG companies. Finally then, this increased willingness to share data results in more and better data and round the circle goes. These steps are both simple and repeatable meaning that we are satisfied that this continues and so we have a spinning virtuous circle. As before, we note that this began from ‘better data’ and is therefore another example where this virtuous circle is true once moving but therefore may have required something different to create the initial momentum.

An additional consideration is that as the amount of data held increases, the value of this data also increases. Whilst there is extensive regulation around the use of data, we are looking at environments where customers are willing to share their data. In these cases, companies are able to gain further benefit whether financial or otherwise which then strengthens their position once more.

In terms of our classification, we are seeing customer value increase in each period as a result of cumulative (data) volume, so we include this as demand side learning effects.

The Economist Intelligence Unit (2015) brings together data usage and our previous topic of employee engagement to describe another virtuous circle. The concept is that engaged employees will follow their leaders' example and incentive initiatives to create an organisational culture that is committed to being data-driven. This data culture will result in greater business success as the company becomes more dynamic and profitable. We accept that this claim holds as supported by research including HBS Online (2019). In accepting this, we are accepting that either unit cost is being decreased or customer value increased or both. Their depiction is that this business success loops back round to leadership by example, but we cannot find a valid supporting argument for this step and certainly not one that would suggest continued spin and the associated cumulative improvements. We conclude therefore that this is a worthy chain which can be demonstrated to deliver competitive advantage but is not a virtuous circle as per our definition.

3.5 - Research & Development

Several research papers refer to virtuous circles stemming from investment in R&D. We examine these separately as we consider R&D to sit outside our previous categories though we recognise it is closest to product enhancement.

We first must acknowledge that R&D investment is not always successful in generating advancements for each individual initiative though we accept that this is the case on an overall and cumulative level.

Our first consideration is that which we refer to as investment in product R&D. Dyson provide an example to examine with Martin McCourt their then-CEO saying:

> 'We have kept investment in research, design and development running very high all the way through both the good economic times and the bad' (Arnott, 2010)

The idea is that investment in R&D and innovation can be considered as reinvesting in delivering ever improved solutions for customers. Where R&D is successful, we can say that these advancements will result in increased customer value. For products that are to some level consumables and will therefore have multiple purchases over time, this will increase sales therefore creating additional funds available for investment in R&D. This cycle continues to spin provided, like Dyson in the example above, there is continued investment in R&D.

The next concept is that the more R&D a company does, the better they become at R&D and the more productive it becomes (Knott, 2018). This is intuitive and does not stand in isolation to the product R&D and therefore the cumulative effect (where R&D succeeds) is greater still.

Bernstein (2000) states ‘R&D spending creates a virtuous circle, where success breeds success’ (p.1) and Watanabe et al. (2003) details the steps:

> ‘Such significant promotions can be largely attributed to the industry’s vigorous efforts to invest in R&D, resulting in a rapid enhancement of its technology contributing to improvement in industry productivity levels. Improved productivity and increase in production induced further vigorous R&D investment, which in turn resulted in further enhancement of technology, leading to the creation of a virtuous cycle between technology and economic development’ (p.2).

These were some of the earliest explicit references to virtuous circles and are here used to discuss R&D at an industry level. The concept here is that investing in R&D will improve industry productivity levels and we can accept this as true on a general level. The assumption then is that these increased productivity levels generate some reduction in unit costs, and this again stands to reason. If we further assume that at least part of this unit cost saving is retained by the company and is in turn reinvested in R&D, we can see the emergence of a virtuous circle. This will hold true and will continue to spin provided the assumption of re-investment holds true.

We can see that with each of the examples above, they are different to our previously accepted virtuous circles in two main ways. Firstly, they are not certain to succeed and in fact we can be sure that it will not always succeed. Secondly, we must always keep the engine running to continue to feel the benefits. Each example requires continued effort and reinvestment in R&D for the stated positive effects. Therefore, whilst we propose that investment in R&D is a virtuous activity, it is the weakest category of our virtuous circles.

3.6 - Other interesting research

There are further interesting research papers and business articles which discuss virtuous circles. In this section we reference these although for different reasons, we have not pursued them as potential virtuous circles as we define them.

Casadesus-Masanell and Ricart are some of the most prolific authors on the topic of virtuous circles. They describe the existence and benefit of virtuous cycles within a company's strategy or business model. They also discuss the non-equivalence of business model and strategy and in doing so use definitions that we do not fully agree with. The principle point regarding virtuous circles is considered robust:

> 'Business models often generate virtuous cycles, feedback loops that strengthen some components of the model at every iteration… As the cycles spin, rigid consequences become more significant, and such virtuous cycles can develop valuable resources and capabilities.' (Casadesus-Masanell and Ricart, 2010, p.5)

In their article 'How to design a winning business model', Casadesus-Masanell and Ricart (2011) say 'Good business models create virtuous cycles that, over time, result in competitive advantage' (p.4). They also introduce the language of self-reinforcing, 'Good ones [Business models] share certain characteristics: they align with the company's goals, are self-reinforcing, and are robust' (p.6).

These strong general points about the existence of virtuous circles support the basis upon which we have tested other examples. Though these references do not provide specific examples that we can examine and test, Casadesus-Masanell and Ricart are one of the authors to use Ryanair's low-cost strategy as their prime example of virtuous cycles as we discussed earlier.

Other authors reach conclusions that virtuous circles can be created within other business functions, for example: leadership development (Allio, 2003); trust and accountability within charities (Hyndman & McConville, 2018); and HR investment (Roca-Puig et al., 2019). These examples, whilst not ubiquitous, cover a significant breadth of business functions in which virtuous circles have been described.

Our assessment is that they do not provide the depth required to explain how each step would lead to the next and ultimately form a loop. Nor do they necessarily demonstrate how the conditions for increasing customer value or decreasing unit costs are met. They cannot therefore be virtuous circles as we have defined them and rather, they appear to be examples of where businesses have chosen these specific business functions to be their point of differentiation with their competitors. We do accept that these could potentially create a competitive advantage through such choices.

Sydow and Schreyogg (2013) published a book on ‘Self-Reinforcing Processes in and among Organizations’. Their lens is somewhat different to ours as we pose a technical test for the existence of a virtuous circle but there is significant overlap in the areas that we each explore. They conclude that there are six types of self-reinforcing strategies: Economies of scale; Network externalities; Learning effect; Adaptive expectations; Coordination effect; and Complementarity effect.

We have come across many of these concepts in our research although often using different terminology and not always accepting that they meet our criteria. We propose that these are effectively just one way of categorising the different ways in which companies may strive to gain a competitive advantage over other companies.

A final theme from our research is the need to keep virtuous circles spinning. There are again multiple examples, all of which support our early affirmation that this phenomenon exists only during a growth phase. Akamai's George Conrades (Carr, 2000) states ‘Now, to fulfill that business model-to keep the virtuous circle spinning-we need to scale up our business fast.’ (p.4). Casadesus-Masanell and Ricart (2011) also acknowledge that Ryanair’s business model exposes them to their virtuous circle becoming a vicious one:

> ‘one of Ryanair’s cycles could become vicious if its employees unionized and demanded higher wages, and the airline could no longer offer the lowest fares. It would then lose volume, and aircraft utilization would fall…’ (P. 6)

3.7 - Virtuous Circles - Conclusions

Our literature review produced many cited examples of virtuous circles and many other references to their existence. These covered a range from:

- Small, single product-specific aspects of a company’s business
- Specific functions of company business
- Whole companies
- Whole Industries

As set out, we assessed whether these met our criteria and, if we determined that there was a virtuous circle present, attempted to classify them (Fig. 10).

	Customer Value	Unit Cost
Economies of scale (Annual Volume)	**Network Effect Driven** Facebook Akamai Apple Uber	**Price Cut Driven** Ryanair Amazon Linux Toyota
Learning effects (Cumulative Volume)	**Product Enhancement Driven** Customer service / Employee engagament Reputational Data Product R&D investment	**Research & Development** Production R&D investment

Figure 10 - Our 2x2 Matrix with classification of examples

As our research developed, a pattern emerged which showed a range of 'purity' of virtuous circles. We developed an analogy of a motor engine to demonstrate that, in the purest examples, we can 'switch the engine off' and continue to reap the benefits as the virtuous circle continues to spin. In the weakest examples, whilst there was a demonstrable increase in the gap between unit cost and customer value, the same or an equivalent level of effort must continue to be supplied (the engine must continue working) for the effect to continue. We therefore built upon our initial 2x2 classification to develop a more involved ranking of virtuous circles with the conclusion that few are able to produce a 'pure' effect where continued effort is not required.

Our ranked results (Fig. 11) were as follows:

Strategy	Examples	Potential to 'Spin'	Purity
Network Effect Driven	Direct Network Effects e.g. Facebook Indirect Network Effects e.g. Apple & Akamai Multi-Sided Networks e.g. Uber	Direct - Pure Spin Indirect – Not as pure	1
Price Cut Driven	Ryanair Amazon Linux Toyota	Not entirely pure, in that you can't entirely turn off the engine. Greatest when there are significant economies of scale	2
Product Enhancement Driven	Reputation/Brand Strength e.g. Patagonia & Toms Continuous Enhancement One-off Enhancement	Reputation can result in direct network effects and therefore almost pure spin	3
Research & Development	Research & Development	Low potential	4

Purest virtuous circle - Can turn 'engine' off and it would continue to spin.

Figure 11 - Virtuous Circle Summary Table

We can take this ranking forward along with the following additional conclusions regarding the creation of virtuous circles:

- They require an innovation or differentiator to kick start the virtuous circle – an engine
- This requires an initial investment e.g. price cut, product enhancement or complementor enhancement
- This must be sufficient to ensure that the company is not dominated by another company within their market
- They exist for a finite period, during industry growth or disruption
- They cease to spin in a mature industry though the competitive advantage may remain

4 - Sectors in the Sports Industry

4.1 - Sports Industry Overview

At an estimated $1.3Trillion (Plunkett Research, 2018), the global sports industry is huge, varied and growing. The sports industry is also of particular interest to the author and we scope three of its major sectors to identify the types of strategies that exist within the industry.

43.6% of the industry is the spectator sports market which includes professional / semi-professional sports teams and clubs, racing and individual sports (Business Wire, 2019). We have chosen not to analyse this sector as sporting strategies have significantly different considerations to ‘pure’ business strategies. Including these in our research and testing in the same way would therefore risk undermining our work and conclusions regarding virtuous circles in business strategy.

We wanted markets that are significant in terms of size and highly competitive so that differences in strategies and competitive advantages would have a chance to emerge. We have chosen to focus mainly on UK based sectors to maintain relevance and consistency of comparisons drawn through our research and interviews.

Based on size, competitiveness and to provide a cross-section of the industry, we have selected the following three major sectors to analyse:

- UK Gyms and Fitness Centres
- UK Sports Tourism
- Global Sportswear and Sport equipment manufacturers

The definitions, inclusions and exclusions of these sectors are imperfect and not always used consistently. For each, we define our parameters and identify where that may differ within other literature or research. Crucially, the distinction is clear between these sectors which enables separate analysis and meaningful conclusions to be reached on each sector.

4.2 - Trends across all the whole Sports Industry

In each of the three sectors that we analyse, we discuss some of the key trends affecting that sector specifically. There are several important factors whose impact is felt right across the sports industry and we outline those here.

Health consciousness and sports participation are both increasing. This broader trend is further supported in the UK where there remains a positive impact from the London 2012 Olympic Games and the many initiatives as part of the legacy project (UK Sport, 2018). This is far reaching as the higher the participation level, the more time spent on activities and the more clothing / equipment is needed. Furthermore, not only does this increase the demand but the willingness to spend increases as customers perceive greater value from a gym membership or running top that they will use more often. Real household disposable income levels are also increasing which is important given that very little spending on sport could be considered essential.

Against this, National minimum wage is increasing which impacts many sectors across the industry especially those with many low-skilled jobs. Free / leisure time has been slightly decreasing and is predicted to continue to do so as the average weekly hours at work increases (Rai, 2019). This reduces the likelihood of individuals spending their time on sporting activities and therefore the likelihood of spending their money on sports related goods and services. Finally, consumer confidence is decreasing, especially related to the EU Referendum result and subsequent depreciation in the value of the pound. This again decreases willingness to spend on discretionary expenses like most across the sports industry.

4.3 - UK Gyms and Fitness Centres

4.3.1 - Sector Overview

This industry sector includes fitness facility operators, specifically gyms and health clubs. These companies generally generate income through membership fees for the provision of access to exercise equipment and weights. Personal training, group classes and other club facilities are sometimes included in membership rates and sometimes for an additional fee (Mak, 2019).

Facilities can generally be classified as low-market, mid-market or high-market. Consolidation has been taking place over the last five years especially at the budget-mid side of the market. The Luxury end has maintained strong performance, and this has resulted in a squeezed middle who have often been purchased by the larger players. Industry concentration is medium-low with the four largest players having 44.4% of market share (Mak, 2019).

This is a growing market and predicted to remain as such. Compound annual growth rate (CAGR) from 2014-18 was 3.2% and for 2018-23 is predicted to be 3.3%

(MarketLine, 2018b). Considerably greater than average GDP growth of 1.5% over the same period (Mak, 2019), this demonstrates an industry in growth.

4.3.2 - Key Statistics

	UK Gyms and Fitness Centres
Revenue £m	£2100m
Profit £m	£168.2m
Profit %	8.0%
Annual Growth 15-20	5.4%
Annual Growth 20-25	2.6%
Wages £m	£558.9m
Wage %	26.6%
Businesses	3616

Figure 12 – Key Industry Statistics (Mak, 2019)

4.3.3 - Major Players

Pure Gym Ltd are the largest player with 15.6% market share. They have pursued an aggressive growth strategy with acquisitions including LA Fitness and Soho Gyms and have also converted many other facilities. Their highly disruptive customer-centric proposition is differentiated from traditional UK gym operators and appeals to a broad range of customers. The key elements of the proposition include affordable membership fees, no fixed term contracts, and '24x7x365' access to high quality gyms. The group's strategy is to continue to roll out new gyms with high returns on capital and drive the operational and financial performance of its existing gym estate.

David Lloyd Leisure Ltd operate at the other end of the market and have been following an expansion plan focused on high-income, time poor consumers. They have secured 14% of the market share in part through acquisitions though they have preferred adding sites rather than whole companies. Their market share, though only marginally lower than Pure Gym is achieved with half the number of sites and half the number of members.

Third, with 7.6% market share, is The Gym Group plc. A new company, only six years old, they operate in the budget segment and have built through establishing strategic locations including inactive boroughs with no affordable alternatives.

Virgin Active have 7.2% of the market and their focus is now high-end collection and large family clubs. They have been adapting their facility range through selling clubs that didn't meet their criteria for the high-end market and purchasing others that could. They provide a competitive range of group classes within state-of-the-art facilities and have added food and drink services through new partnerships.

4.3.4 - Competitive Advantage

We have identified that there are currently two key strategic groups within this sector. Whilst much of the analysis is consistent across both groups, we are clear to differentiate where appropriate. Strategic group A (SGA) is the budget end of the market and strategic group B (SGB) is the high end of the market.

In SGA we have companies including Pure Gym Ltd and The Gym Group where their strategy is primarily price cut driven. The major costs are rental or owned premises costs, equipment purchases and staff costs including trainers, cleaning and maintenance staff. Though there are some attempts to minimise expenditure on these such as reducing staffing numbers, these costs are generally considered necessary to meet customers minimum requirements. There are however many tactics utilised to increase utilisation of space and equipment which therefore reduces unit costs. These include off-peak memberships which encourages greater use outside peak hours and the '24x7x365' memberships referenced above.

As we found in Chapter 3, the extent to which a virtuous circle can be established through this price cut route is limited. The effect is greatest when the effect of economies of scale are greatest, so we look at that here. Having identified the major cost structure, we see that there are not vastly significant economies of scale in this sector. Greater bargaining power is likely to result in marginally improved prices for equipment purchasing but not across the major rent and staff costs.

In SGB we have companies including David Lloyd Leisure and Virgin Active where their strategy is to provide an enhanced product and service. David Lloyd demonstrate a commitment to an enhanced experience:

> 'we provide more than just amazing fitness facilities, we also have health and beauty spas, lounges with free Wi-Fi, crèches, nurseries and specialist sports shops.' (David Lloyd, 2019)

This in turn means that there are less substitutes for this higher end market. The service and experience on offer are not readily available in every gym and members are willing to pay a premium for this. Corporate memberships are also more prevalent in the higher end of the market and these corporations will be less price sensitive than many individuals especially considering the reputation effect. As we concluded earlier, the creation of an enhancement can be very powerful, especially if the reputational aspect is such that it begins to create network effects. The higher end companies are therefore able to achieve higher profitability through having less valid substitutes and this is even more true where a company creates a true niche / specialism.

4.3.5 - Winning Strategies

Growth at both ends of the market balances out to a degree but with slightly more at the budget end means that average profitability is decreasing and predicted to continue to fall further.

Against the average profitability of 8%, the large budget gyms achieve roughly this level where higher end clubs achieve c.12%. Given the medium-low industry concentration, the remainder is then largely made up of small, independent facilities who operate on subsistence / low margin levels. Niche clubs however can achieve c.20% profitability and this is due to lower forces in both threat of substitutes and new entrants.

We explored this in an interview with Terence Etim (19/11/19), an Ex-UFC professional fighter and now senior coaching staff at Kaobon Gym, Liverpool. This club has been a success by any measure and, having formed in 1992, is now profitable with margins towards the top end of the sector as well as an incredible record of producing professional fighters.

One early realisation is that this club never makes financial / business decisions at the expense of producing the best athletes. Terence is clear “we could have many more people in the gym, but we want to make champions”. Their success then is built around and anchored in a reputation for delivering more UFC fighters than any other UK gym. UFC (Ultimate Fighting Championship) is the ‘premier league’ of Mixed Martial Arts and the 7th largest sports brand in the world (PledgeSports, 2018). Etim was a central part of this having been attracted by the prospect of training alongside world class athletes and then going on to become one of the most successful UK MMA fighters ever. In turn, this attracts more potential future champions as well as providing both the aspiration and the know-how to compete at the very top level. Another key aspect is the head coach, Colin Heron, who has overseen all the success. Etim describes Heron as the “magic ingredient” adding that “he is the only Luta Livre black belt in England” and “his strategies are unparalleled”. We recognise this skill set as a valuable resource which is a source of competitive advantage over competitors. It is perhaps easy then to see how this could be a virtuous circle in terms of sporting performance but how does this translate to financial / business performance?

The number of classes being run has risen dramatically with a range of children’s sessions through to open adult sessions as well as those limited to elite / professional fighters. The sense of belonging that surrounds the club as a result of the reputation for results means that they are essentially full. This is achieved with zero marketing costs because word of mouth amongst those interested in MMA is more than enough to keep them operating at capacity.

The fact that they are not currently in a growth phase means that they are not benefiting from a virtuous circle in the business sense as we defined it, though it is conceivable that they could be. Expansion is always possible and indeed they have granted permission for several clubs to operate effectively as franchises. Ultimately their determination to prioritise sporting success and not risk diluting their valuable resources through expansion is admirable and no doubt that determination is part of their winning formula.

We can see similar high profitability elsewhere in the sector with niche or boutique clubs and fitness classes such as Peloton, Body Machine Performance Studio and Animal Flow just to name a selection. Many of these are currently riding the crest of a wave and therefore benefiting from a virtuous circle within their trend specific growth phase. We note that trends within the fitness industry are fast moving and so we would require continued effort in the form of innovation in order to maintain their position. We therefore don’t see long-term examples of ‘pure’ virtuous circles here.

4.4 - UK Sports Tourism

4.4.1 - Sector Overview

Sports Tourism can be considered travel which includes either participation in or observation of sports events and activities. This is generally considered as a part of the Tour Operators Industry and in analysing this sector, we begin with the accumulated data and major players for UK Tour Operators and assess where, how and why the Sports Tourism sector contributes to the larger industry. One major difference to highlight is that most Tour Operator packages are ‘off the shelf’ whilst most Sports Tourism packages are bespoke or at least customisable (Gardner, 16/11/2019). It is also worth noting that customers for sports tours are more likely to be organisations (e.g. clubs and schools) who are purchasing packages though some are open to individuals also.

The broader industry is declining in its contribution to GDP and its Growth is predicted to be 0.8% CAGR through to 2024 (Crundwell, 2019). Despite this, Sports Tourism is fast growing on the back of increasing interest in sport, healthy living trends and increasing willingness to spend income on experiences rather than products (MarketLine, 2018c). That millennials are driving this trend (Hoffower, 2019), makes this a sector of considerable interest over the coming decades. The growth across Sports Tourism makes it a potential ground for companies to create virtuous circles.

Under 34's is the largest market segment of the overall Tour Operator industry in terms of customer numbers although, on average, they spend slightly less than 35-49 segment. They are the most likely to book sporting activity and events-based packages at both ends of the cost spectrum (Camping and Hiking through to Skiing). Concentration in both the larger Tour Operator industry and Sports Tourism are low with the four largest companies making up 20.9% of the larger industry. No comparative data is available for Sports Tourism but the presence of many smaller players providing bespoke packages within their niche would produce even lower concentration.

Industry globalisation is an interesting concept in this sector and not straight forward to assess. 68.7% of the revenue is UK residents travelling overseas with a further 5% being overseas residents travelling within the UK. Most operators and all large operators are international though consumers typically make bookings through an operator with a significant base in their home country.

4.4.2 - Key Statistics

	UK Tour Operators
Revenue £m	£13500m
Profit £m	£555.2m
Profit %	4.1%
Annual Growth 15-20	-0.1%
Annual Growth 20-25	1.3%
Wages £m	£828.7m
Wage %	6.1%
Businesses	2036

Figure 13 – Key Industry Statistics (Crundwell, 2019)

4.4.3 - Major Players

TUI Travel Ltd is the UK based business of TUI Group. They have 14% of the overall market and, with the exit of Thomas Cook, are the largest player by far. They formed from a merger of First Choice Holidays and the Tourism Division of TUI AG and operate through subsidiaries including Thomson, Airtours and Gulliver Travel. Their model is to offer a fully-integrated holiday package at a consistently high (though not luxury) standard. In a generally static market, they are experiencing continuing growth through their Sports Tourism subsidiaries such as Crystal Ski Holidays, Great Atlantic Sport Travel, My Planet Sport and Sport Abroad.

Virgin Holidays Limited achieve 4.7% market share having originated following Virgin Atlantic Airways. They are now the market leader on transatlantic routes to Florida and the Caribbean. They continue to grow through acquisitions and introductions focused on the luxury holiday market. In terms of Sports Tourism, Virgin focus more on luxury active holidays incorporating surfing, water sports, skiing and hiking rather than participation or spectating competitive sporting events.

DER Touristik UK Ltd is the largest remaining player. They have 2.2% market share and operate in the UK as Kuoni Travel. They operate at the luxury end of the market with a range of Honeymoon, Safari and other exclusive packages. They also have a sizeable active holiday range of packages including Ski, Sailing and Water-sports, and tailor-made packages which all have potential to carry higher margins.

The remaining 79.1% of the market is made up of comparatively smaller operators, many of whom have attempted to carve a niche for their business either in terms of the geographical area they serve customers from or specialising in the types of packages and / or the destinations they offer.

4.4.4 - Competitive Advantage

Some companies do operate with low cost business models where they try to drive costs down. Sports-tours.co.uk for example offer comparatively low-cost packages for established tournaments. There is no evidence to suggest that such companies can achieve profit levels above the industry average of 4.1% (Crundwell, 2019).

As previously, we examine the importance of economies of scale in the industry. Primary costs are purchases from the providers of the different parts of the package such as transport, accommodation, food and drink and activities. Bulk buying is more prevalent in the broader Tour Operators industry as customers there are generally selecting ready-made packages. Economies of scale then are less significant in the Sports Tourism sector where customised packages reduce the ability to benefit from scale and bulk purchases. There remain some benefits to scale through spreading the costs of booking systems, marketing costs etc but we conclude that there is little scope for creation of a price cut driven virtuous circle here.

We explore product enhancement which, given that the sector is dominated by bespoke packages and niche offerings, provides ample opportunity for differentiation. Packages which offer a specific and hard to replicate experience such as entry places to an exclusive event or tickets to a very high demand sports match may be perceived as almost without a true alternative. The creation of this exclusive experience is therefore a critical factor in developing a competitive advantage.

Creating bespoke packages for schools, clubs and other groups is not easy without significant prior knowledge of the destination and event(s). Building a reputation for delivering enhanced customer experience, locally or nationally, and usually within their chosen niche is essential for operators.

Where companies can achieve this, the conditions allow the emergence of a virtuous circle. Moderate benefit can be gained where the experience is such that a premium can be charged resulting in above average profitability. It is stronger when companies can carve out a niche where they are able to provide an exclusive experience that customers cannot, or at least do not believe they can, find elsewhere. The virtuous circle is greatest when the enhancement results in a superior reputation which then starts to produce direct network effects on top of this.

4.4.5 - Winning Strategies

Above, we reference the companies who are successful in carving out a niche market. MSG Tours are one such company who specialise in Sport (playing and supporting), whilst also providing Ski and Study related travel. Our interview with Founder and CEO Mark Gardner (16/11/19) shone a light on this and highlighted some of the reasons they are able to achieve significantly above the average industry profitability.

They are a business “built on a passion to deliver the unexpected, striving to surpass expectations in customer service and overall travel experience”. In discussion with Gardner this comes through constantly and very strongly. In his words “we work tirelessly on creating secret ingredients that make people feel special” and focusing on “what do we want the experience to be. Not just the three weeks [of their tour] but the 18 months before”. Gardner talks at ease listing examples of these “secret ingredients” from birthday messages and treats if they occur on tour through to exclusive warm up invitations and events in advance of their main trip.

For the first half of the interview, we discuss this experience element and another striking revelation is that they consciously limit numbers and access to certain key events / tours. Like other successful but smaller companies, they have a specialism even within the categories above and that is Rugby related tours, both spectating and playing. Their major products then include trips to the Rugby World Cup, recently in Japan, and British and Irish Lions Tours to southern-hemisphere nations. On one level this is simple supply and demand economics, and these are highly sought products that simply don’t have valid substitutes for the target market. As Gardner explains, “once people get access it’s no longer about the price” and this enables great customer satisfaction at above average margins.

The second half then was very illuminating and really helped bring to life the example that we explored in our literature review regarding employee engagement and the virtuous circle around this and creating a superior customer service / experience. What emerged was an incredibly strong example of the power of investing in bringing in the right people and then empowering them in terms of the right tools, trust (and coffee!) to ensure they are willing and able to deliver a service and experience that customers simply don't believe they can get elsewhere.

As outlined in our earlier section, this virtuous circle is created through increasing customer value and has resulted in MSG Tours experiencing four-figure growth in some of their higher margin products.

4.5 - Global Sportswear and Sport equipment manufacturers

4.5.1 - Sector Overview

Here we examine a selection of sportswear and sport equipment manufacturers. Industry data is gathered in very inconsistent methods for these sectors with some analysts combining the two sectors. By way of example, some reports include footwear whilst others do not and the treatment of commercial equipment (e.g. gym equipment is also inconsistent. Many of the companies discussed offer products across both sectors but it is usually clear what their core is. We consider them alongside each other due to the cross over but prefer separate analysis as the strategies at the heart of the companies differ. For us, sportswear refers to clothing and footwear used to provide comfort or advantages such as flexibility or sweat protection during activity. It includes activewear, a new categorisation which may not always strictly be intended for wearing during sporting activity but does not include wearable technology such as Fitbit and Garmin. Our consideration of Sports equipment then excludes footwear and clothing and includes equipment for all sports and indoor and outdoor activities such as ball sports, wheel sports, winter sports, fitness and gyms. We look at these on a global level as the sectors are highly globalised and the major players all operate across multiple regions.

The global sportswear market is expected to grow at CAGR of 3.4% over the next five years (MarketWatch, 2019) whilst the CAGR for the global sports equipment market 2017-22 is expected to be 4.7% (MarketLine, 2018a). The size of these companies and their reach within the sports industry, as well as being in a significant growth phase, makes them of interest in our research on virtuous circles.

Sportswear is generally wearable across multiple sports so there is natural scope for companies to grow larger meaning the sector is more consolidated than sports equipment where companies are often more specialist. This provides scope for two different forms of product enhancement in order to provide a competitive advantage for the company. Whilst both have an important reputational element, Sportswear is more about brand equity and sports equipment is more about specialist excellence within a niche.

Both sectors have seen forward integration into retail from many of the largest players and we examine these later.

4.5.2 - Major Players

Within Sportswear, the major players are Nike, Adidas, Puma and Under Armour. Examining their strategies shows some expected similarities and some interesting differences in focus.

Nike's mission statement is ‘To bring inspiration and innovation to every athlete* in the world’ (Nike, 2019). Nike’s wide reach may be explained as much by the Asterix as by their main statement. Their commitment to reaching a wide population couldn’t be clearer as the * reveals, ‘if you have a body, you are an athlete’.

Adidas’ strategy states ‘We’re all ‘Creating the New’ – because we believe that, through sport, we have the power to change lives’ (Adidas, 2019). They expand on three priorities of: ‘Speed’ of innovation to market; ‘Cities’ and the importance of global urbanisation; and ‘Open source’ meaning their commitment to co-creation with consumers, athletes and partners.

Puma’s strategy is ‘to be the fastest Sports Brand in the World’ (Puma, 2019). This is supported by their Corporate logo of ‘Forever Faster Puma’. In addition to the benefit of the link with speed in their sporting context, this is primarily, like Adidas, a commitment to having speed of innovation to market.

Under Armour's mission statement ‘To make all athletes better through passion, design and the relentless pursuit of innovation’ (Under Armour, 2019). Again, we see the innovation point emerge but the focus here is a little more on performance sport and athletes. This differential is supported by their brand statement that ‘Under Armour is built on performance’.

Within Sports equipment we see many non-sport-specific companies including those above who produce equipment across a range of sports. But this market has a much greater emphasis on smaller and niche players who benefit from deeper expertise in their specific sport / area and therefore can offer superior customer value.

Halfords and Mountain Warehouse are large UK examples of this focus. Halfords offer cycling and travel related products and by far their largest markets are leisure and family cycling. Their product offering is narrow, and their strategy is ‘To inspire and support a lifetime of motoring and cycling’ (Halfords, 2019).

Mountain Warehouse primarily offer camping and hiking clothing and equipment. Their strategy is ‘a relentless focus on value for money’ (Baldwin, 2019 - citing CEO Neal). Neal also believes that the trend in consumers desire for sustainability will result in this becoming more important than in-store experience over the coming decades.

The market consists of many more of these specialist / niche companies including: Gray Nicolls (Cricket); O’Neills (Gaelic Sports); Spalding (Basketball); and Wilson (Tennis).

4.5.3 - Competitive Advantage

Some companies like Karrimor and Quecha operate low cost strategies. These products are generally considered low-tech or lower quality substitutes which may not always be offering the same performance benefits.

Economies of scale are considerable in these sectors especially through bulk buying of materials, spreading overhead costs of production premises and managing costs through efficient logistics networks. Combined, these can produce a competitive advantage for companies but as discussed earlier, they are not benefiting from a strong virtuous circle to the extent that they gain continued advantage without continued effort. The most benefit can be gained where companies are able to establish a reputation for delivering great value for money. Clearly this contains a price cut element, but we assess that the reputational factor is the more prominent effect.

As introduced above, the primary methods of product enhancement differ across these two sectors. In Sportswear, brand equity is key. This can be built around traditional areas such as design, quality and performance but also increasingly around factors such as sustainability as supported by Mountain Warehouse CEO Neal (Baldwin, 2019). We see these companies committing within their strategies and mission statements to the factors that they want to build their reputation around like with the examples above.

In Sports equipment, confidence in the equipment purchase is key. This can come from some of the reputational factors above but also from an assurance of specialism and expertise both from a manufacturing perspective and a retail perspective. There is great value when customers know that they have access to experts in the given field who can provide an enhanced service in selecting which bike, fitness equipment, cricket bat or tent is best for them. We see many of the more profitable sports equipment companies pursuing this forward integration into direct sales both through traditional retail and dedicated sales teams.

Small independent manufacturers are still possible and a frequent occurrence. Such entrants are unlikely to be able to compete with Sports Direct on prices but can be successful in custom-made equipment or through creating another niche.

4.5.4 - Winning Strategies

When looking at which manufacturers are able to achieve above average profitability, we find that it is those who have established a reputation for driving higher customer value. This can be achieved in different ways including enabling performance gains through to how you feel wearing something or simply the extra kudos from your friends from wearing Nike trainers.

There are a range of strategic choices which successful players utilise to create this. The most prominent is a range of ambassadors, endorsements and sponsored athletes which all the big four and many others utilise. This is such big business that most of even the best paid and most successful athletes earn more money through these deals than through their salaries.

Companies utilise these to advertise their products, especially new ranges and to associate them with the type of sport and athlete that they want to establish a reputation for. As referenced with Adidas above, they also use athletes to test their product so that they can develop further before public launch (Elson, 2019). This appears a credible method of kick-starting a virtuous circle based on reputation for superior products and when supported by athletes that are often idolised, this can be sufficiently strong to generate direct network effects and reap the further benefits that they bring.

To provide a case study on sports equipment, we interviewed Tony Vaughan (20/11/19), Sales Manager – Education Sector for Matrix who are a premium fitness equipment manufacturer. As you would expect, being at the cutting edge of technology, sports science and fitness trends is fundamental to their business success. This too is of course true for their competitors and as the conversation progresses, you get the feeling that their real battleground for establishing a competitive advantage is around what Vaughan describes as “Value add”. Their offer then “goes way beyond the equipment” and includes a wide range of extras from staff training through to experience days with high profile partners such as Wasps Rugby Club.

Vaughan’s understanding of wider societal, and Higher Education sector, trends regarding mental health and general wellbeing is clearly an area that Matrix are determined to be a positive force within. Knowing that students’ preferences around taking part in school sports clubs means that gyms are increasingly important for ensuring the well-known health benefits of an active lifestyle are possible. Expanding into outdoor equipment is a relatively new area for equipment providers. Matrix are looking to be part of the ecosystem that generates the camaraderie that comes from outdoor activities and classes.

One of the final parts of our interview stresses the additional importance of data usage and helps us understand this example from our literature review. This data usage is especially important for influencing future sales strategies and product development.

4.6 - Sports Industry Analysis - Conclusions

Our research of our chosen sectors identified key strategies that create virtuous circles. We have classified these within our ranked list of virtuous circles as developed in Chapter 3 (Fig. 14).

Strategy	Examples	Potential to 'Spin'	Purity	Within Sports Industry
Network Effect Driven	Direct Network Effects e.g. Facebook Indirect Network Effects e.g. Apple & Akamai Multi-Sided Networks e.g. Uber	Direct - Pure Spin Indirect – Not as pure	1	Such strong reputation that it becomes direct network effect. E.g.: - Kaobon Gym - MSG Tours - Nike - Matrix
Price Cut Driven	Ryanair Amazon Linux Toyota	Not entirely pure, in that you can't entirely turn off the engine. Greatest when there are significant economies of scale.	2	The purest of the price cut virtuous circles occur when economies of scale are a significant factor. E.g.: - Pure Gym, The Gym Group - Sports-tours.co.uk - Karrimor, Quecha
Product Enhancement Driven	Reputation/Brand Strength e.g. Patagonia & Toms Continuous Enhancement One-off Enhancement	Reputation can result in direct network effects and therefore almost pure spin	3	Most prevalent within the sport industry. E.g.: - David Lloyd, Virgin Active - TUI Travel, Virgin Holidays - Adidas, Puma, Under Armour - Halfords, Mountain Warehouse, Gray Nicolls, O'Neills, Spalding
Research & Development	Research & Development	Low potential	4	Not a major factor in our research of the sector.

Purest virtuous circle - Can turn 'engine' off and it would continue to spin.

Figure 14 - Conclusion Summary Table

Product enhancement driven effects are most prevalent within the sports industry. The strongest of these are factors around reputation and customer experience which can create direct network effects and the purer virtuous circle that this generates.

Our case studies demonstrate real-world examples of such 'winning strategies' and were brought to life with first hand research from key business personnel.

5 - Overall Conclusions

Our research has assessed how companies within the sports industry can create a virtuous circle strategy.

We began by defining what we meant by a virtuous circle strategy on both a conceptual level and a more technical, business profitability level. This was essential as, whilst there are increasing numbers of references to virtuous circles in academic literature and practitioner-oriented journals, there is not an established consistency of language or concept.

In forming our definition, we set criteria that could be tested and an initial 2x2 classification which we intended to categorise examples of virtuous circles within. We researched extensively and found a wide range of references to virtuous circles.

We tested each example against the criteria and quickly found that there were different purity levels of virtuous circle. We developed an engine analogy to help discuss this and established that all virtuous circles required an initial effort by way of investment, innovation or differentiation – i.e. an engine to get them running. Taking this further, we state that with a 'pure' virtuous circle, you could then turn the engine off and continue to see the benefits of the circle spinning. We used this to develop our 2x2 classification into a more mature profiling which considered the 'purity' of the virtuous circle. This can be thought of as the extent to which continued effort is required from the 'engine' in order to see continued benefits.

With our understanding of the types of virtuous circles that exist within literature, we sought to apply this on a practical level to chosen sectors of the sports industry. Whilst the selection of three specific sectors limits the generalisability of the results across the whole sports industry, this approach provided a deeper dive across sectors less affected by the impact of professional sporting strategies.

We analysed the selected sectors and identified the strategies of the major players and those who were able to achieve above sector average profitability. We conducted interviews to provide even greater depth of analysis for relevant examples of successful case studies within each sector.

Our ultimate conclusion to our problem statement is that there are four broad types of virtuous circles which are:

1. Network Effect Driven
2. Price Cut Driven
3. Product Enhancement Driven

4. Research and Development

Direct network effects produce the purest virtuous circles. The purest of the price cut virtuous circles occur when economies of scale are a significant factor. Within the sports industry, the impact of economies of scale varies significantly across sectors. To assess the possible creation of this type of virtuous circle, you must therefore establish that impact.

We conclude that to create virtuous circles within the sports industry, companies should focus on product enhancement and specifically on building superior reputation and customer experience. These can be so strong that they result in direct network effects and therefore become pure examples of virtuous circles.

Our research then has developed a fresh, formal definition of a virtuous circle within business strategy. We have also introduced a new conceptual analogy of an engine to kick start the virtuous circle and a new concept and method of categorising the purity of them.

This could provide a useful footing for both practical applications and theoretical developments. Practitioners can use our findings to create the conditions required to benefit from a virtuous circle within their business environment. Future research could build upon this work to reach further conclusions regarding the relative strengths of these categorisations of virtuous circles. Particular benefit could be gained by further understanding what is required within a product enhancement virtuous circle to achieve the purity and additional benefit of direct network effects.

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7 – Appendices

7.1 – Appendix i – Problem Statement Worksheet

Define the problem using the Problem Statement Worksheet

Problem Statement

How can companies within the sports industry create a virtuous circle strategy?

Current situation/context

- The Sports Industry is huge and growing and is therefore an attractive industry where opportunities for profitability exist
- The client has a deep interest in the sports industry
- The client has an interest in business strategy and in particular those that benefit from a virtuous circle
- The client wishes to demonstrate their tools, analytical and other skills for the purpose of their MBA project and potential career development opportunities

Decision makers & stakeholders

- MBA Candidate & "Client" (Jarlath O'Hara)
- Supervisor (Ian Mackenzie)
- Connections within the sports industry - 1st degree and beyond
- Potential beneficiaries from identified opportunities – ie players within the Sports Industry

Success criteria

- Different sections of Sports Industry scoped with the different types of strategies identified
- Data gathered and analysed to produce substantiated observations
- Patterns identified in successful strategies and the presence of virtuous circle within these
- Opportunity/ies identified for new or existing players within the sports industry

Constraints & scope

- Individual players, athletes and coaches are out of scope
- Professional sports clubs are out of scope
- Sports Betting (Gambling) is out of scope
- Remaining scope of Sports Industry is very wide and may be refined as the project develops

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