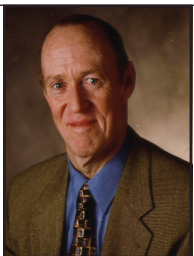


How to

Low Cost Thrive Against Competitors

[management solution]



by Richard P. Boggs

Due to industry-wide sales techniques, such as price drops and closeouts, the health club industry is rapidly moving toward selling the product of exercise as a commodity. If this behavior remains, then price will be the industry's only vehicle for differentiation. This means of competition cannot sustain growth and profitability over time, especially in an industry whose profit margins are already challenged by increasing equipment costs.

As noted in industry publications, some leading, national health club chains are offering \$19 down/\$19 per month membership deals, while others are working to lower their monthly fees to as little as \$5 per month. You can bet this trend will have many imitators in a short period of time.

How can high-quality clubs compete in such an aggressive price war? How can single-club owners survive? The choice is simple. Clubs can either slash their prices to meet or beat their "cheapest" competitor, or they can differentiate themselves in such a way that price is no longer the issue.

Creating consistent experiences.

Even though the Starbucks Corporation is not a member of the industry, perhaps health clubs should examine how such a highly-successful business has differentiated itself and has risen above price competition. Starbucks has become highly profitable without any discounting, frequent-usage promotions or giveaways. Since the company incorporated in 1987, Starbucks has grown to over \$4 billion in annual sales and has opened over 7,200 stores¹. The key to Starbucks' explosive growth is creating "raving fans" of the consistent, memorable experiences they provide. As a result, they are able to charge one of the highest, if not the

highest price per cup of coffee in the market. No patents, no secret formulas, just consistent experiences.

The Starbucks success story exemplifies the teachings of management consultants, Joseph Pine, II and Joseph Gilmore, in their 1999 book, "The Experience Economy." In this book, the authors encourage businesses to pursue other means of differentiation outside of price (Figure 1-1). Pine and Gilmore use coffee as an example of enhancing the value of a commodity by associating it with a memorable experience. By creating a distinctive experience, businesses are able to increase the value of a commodity (coffee or exercise) to a level at which consumers would pay a premium to have that experience. In addition, consumers are much more likely to remember the experience associated with the commodity, rather than the commodity itself.

How does the Starbucks example relate to the fitness industry and the ominous \$19 per month competitor?

Starbucks' product and market demographics parallel the fitness industry. Just as there are no patents or secret formulas for coffee, there are no exercise routines that are the sole property of a facility and no pieces of equipment that facilities are unable to purchase. For this reason, health clubs must differentiate themselves from competitors by offering their members consistent, memorable experiences, which removes price from the equation and creates "raving fans."

The market potential for group fitness participants is significant, as demonstrated in a June 2000 Club Business International article by Jim Annesi, Ph.D., and Patricia Amend. The article noted, "Research has clearly and consistently demonstrated that exercise adherence is improved

when a sense of group camaraderie or 'cohesion' exists." For this reason, the study also cited the fact that 90 percent of all exercisers report they prefer to work out in a group.²

Just as Starbucks packages coffee around consistent experiences, health club owners can package exercise around consistent experiences. Management, programming, training and marketing systems are available to help clubs create "raving fans" by utilizing the large appeal for group fitness. Numerous clubs utilizing these systems have faced competition from cheapest-price competitors. These clubs have not only weathered the storm, but have gone on to prosper by retaining current members, attracting new ones and by creating unique and consistently superior experiences.

If you are interested in learning how to use these systems to differentiate your business and create consistent, memorable experiences, attend a free, one-day group fitness management seminar. Please note that differentiating through group fitness is a process that takes between 12 and 24 months of consistent focus by a club's management team to implement. Similarly, the Starbucks experience was not created overnight; rather, it is the result of years of focus and refinement.

Source: The Experience Economy, B. Joseph Pine II and James H. Gilmore; p.1-2

(Footnotes)

¹ Fiscal year ended September 28, 2003 as noted in 10-K dated December 23, 2003.

² CBI, June 2000, p.40.

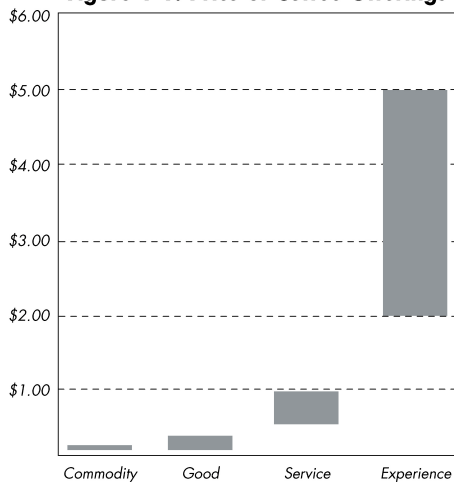
*"Consider, however, a true commodity: the coffee bean. Companies that harvest
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coffee or trade it on the futures market receive – at the time of this writing – a little more than \$1 per pound, which translates into one or two cents a cup. When a manufacturer grinds, packages, and sells those same beans in a grocery store, turning them into a good, the price to a consumer jumps to between 5 and 25 cents a cup (depending on brand and package size). Brew the ground beans in a run-of-the-mill diner, corner coffee shop, or bodega and that service now sells for 50 cents to a dollar per cup.

So depending upon what a business does with it, coffee can be any of three economic offerings – commodity, good, or service – with three distinct ranges of value customers attach to the offering. But wait: Serve that same coffee in a five-star restaurant or espresso bar, where the ordering, creation, and consumption of the cup embodies a heightened ambience or sense of theatre, and consumers gladly pay anywhere from \$2 to \$5 for each cup. Businesses that ascend to this fourth level of value (See Figure 1-1) establish a distinctive experience that envelopes the purchase of coffee, increasing its value (and therefore its price) by two orders of magnitude over the original commodity.”

Figure 1-1. Price of Coffee Offerings



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