

Analysis of virgin actives strategy



**ASSIGN
BUSTER**

This report provides an analysis of Virgin Active's (VA) strategy and an assessment of its sustainability, given the issues facing the overall UK health and fitness industry. Research in the UK suggests that there is a ceiling in the percentage of the adult population that will join a gym (15%), which the sector is forecast to meet in 3-5 years. Given current growth rates, VA membership is specifically forecast to reach full utilisation within 4 years. Against this potential market saturation, the industry must also contend with high membership turnover rates, as clubs compete for consumers' disposable income and time against a wide range of leisure activities. Consequently, VA's greatest strategic issue is the need to find new avenues for future growth while continuing to satisfy the demands of its equity investors.

VA is currently a successful, well-managed business. From its inception in 1999 it has pursued a vision to become the biggest mid-market player in the health club sector. By scaling a proven model and leveraging opportunities in its external environment, it has grown to nearly 310, 000 members in over 70 clubs throughout the UK. This aggressive growth strategy has seen VA outperform the market by 2% in recent years and has allowed it to capitalise on economies of scale. While the business gives approximately 30% returns to the VA equity investors (it is 80% equity funded), after three years the current strategy will not be enough to provide such favourable returns.

Growth needs to come from new areas and this will require a significant strategic shift. Repositioning the clubs will attract different people during off-peak hours and will also encourage greater loyalty and retention, potentially increasing club utilisation from the current 72% to upwards of 90%.

Additionally, each new member spreads the high fixed operating costs of running a health club across more customers, causing additional members or longer memberships to significantly increase operating profits. To achieve high utilisation, Altitude 5 recommends that VA work to re-position the business from a traditional health club format to a broader social centre – for example, Virgin Active to Virgin Heart (as in, Virgin at the heart of the community it serves).

Introduction

Virgin Active Overview

Virgin Active (VA) came into existence when two friends, Matt Bucknell and Frank Reed, went to Richard Branson with an idea to start the UK's first branded health club chain. In keeping with the Virgin spirit, it went against the trends of existing health clubs by offering a “lifestyle,” excellent customer service and no annual contract or joining fee. (Brennan 2009) In 1999 VA opened its first health club in Preston, away from the glare of London-based media, and was an immediate success – 4, 000 members signed up before Branson opened the doors. It was a success and a period of high growth began, including international expansion (VA entered the South African market through an acquisition two years after opening).

In 2002 Richard Branson sold his stake in VA to the Private Equity firm, Bridgepoint. Branson subsequently regained control of Virgin Active in 2005 and in the same year the company's UK expansion plans started with the acquisition of three Esporta health clubs for £1. 25m. In the following year the growth of Virgin Active in the UK accelerated when Virgin purchased 47

Holmes Place clubs, giving it the critical mass the company sought within the mid-market segment. (Brennan 2009)

Today the chain is run by Peter Brennan and majority owned by the Virgin Group (75%); the remaining 20% is owned by private equity (Bridgepoint and Permira) and 5% by the management. The UK parent VA holding company has 6 international subsidiaries (UK, South Africa, Italy, Dubai, Australia and Portugal). All three owners are represented on the Board. In the UK there 309, 000 members in 71 clubs, over 40 of which are in the affluent South-East, and has the third highest market share in terms of members at 5. 5% (Fitness First is the industry leader with 8. 7%, followed by David Lloyd with 6. 3%). The group currently has no plans to make any major acquisitions, and will instead focus on existing individual club locations to purchase. (Brennan 2009)

Business Model

When the business of VA is observed, the brand of the company comes across as one its core strengths. The “ Virgin brand” in other industries is also very strong and VA leverages this resource for their own business. In addition to that, their other core capabilities are quality equipment and a culture that infuses values of Virgin, which are fun, innovation, value for money.

The value proposition offered by VA is a fun and healthy lifestyle with superior customer service in a spacious environment. These services are offered at an all inclusive price with no hidden charges. Target VA locations have at least 100, 000 ‘ ABC’s’ (the top three socio-economic classes) living

within an 8 minute drive from the gym. The current population in this socio economic class is about 18 million in the UK.

The maximum capacity of VA is about 1.5 members per sq metres, i. e. 6000 members, but the maximum capacity at any one point of time is restricted by the number of lockers which is 700. However the business model works because on an average they have 400 members at any given point of time in the busiest of their centres.

Particulars 2007

Annual

(in pounds)

Revenue per member (estimated)

600

Operating Cost per member

466

Operating Profit per member

134

Operating Cost per sq. metre

473

Operating Cost per member (using 1.5 members per sq. metres, ie at maximum capacity)

315

Average number of members to break - even

3153

On the analysis of the financials, the operating cost per member is calculated to be close to £466. About 3, 150 members are required per gym in order to break even. Presently they have 4000 members per gym on an average.

Estimating a £50 per month membership fee, it can be said that the business is making a handsome operating profit even when there is a 72% capacity utilisation. The company can operate comfortably at 95% level, which would further increase the profits as there will be a nominal increase in fixed costs, which constitute more than 90% of the total costs of the gyms. To clarify the operating cost per sq metre of a gym is about £473. If the gym works at the maximum capacity the operating cost comes down to £315 per member thereby increasing the profits. To summarise,

VA has achieved economies of scale, with the potential of improving it further;

Each new member in the existing gym adds to the bottom-line profits as variable cost as a percentage of total cost is very low; and

VA is working at a utilisation rate of close to 72% which leaves a further 23% capacity to be utilised comfortably.

Industry Analysis

The UK leisure market environment has a very competitive landscape and must be assessed within the UK leisure market as a whole, including exercising outdoors, such as walking and cycling, which remains the principal alternative to health clubs. Private health and fitness clubs compete with municipal leisure centres that offer cheaper monthly deals and pay-as-you-go options - today, 18% of adults in the UK use public and only 11% private fitness facilities. In 2008, the private health and fitness club market was worth £2.6 billion, with 5.6 million members. From 2003-2008 both revenue and member numbers increased by about 40%. (Mintel 2009)

Revenues and value growth of private and public facilities are shown in Figure 1. While growth in public facilities is set to stagnate just below 2%, revenues of private operators are expected to fall by 3% in 2009 and thereafter continue to grow by more than 5%.

Figure 1 Value / Revenues (£m) and Growth (%) of UK private and public health and fitness facilities

Source: Mintel 2009 and own calculations

The UK fitness and health industry has experienced in recent years a consolidation process and take-over activity by private equity firms. In 2006 VA bought Holmes Place, LA Fitness acquired Dragons, and Bannatyne purchased LivingWell Premier clubs. Most of the large operators have PE involvement. According to an expert of the Fitness Industry Association (2009) further take-over activity is unlikely during the recession. Once the markets recover, however, a trend back toward greater public ownership is

expected as PE investments have reach maturity and exit strategies are assessed. Management buyouts could be alternatives to public offerings. The market is highly fragmented with a moderate eight-firm market concentration ratio of 40%. 60% of the market is still served by small operators leaving significant scope for further horizontal acquisition. (see Table 1)

Table 1. Market Size and Share of Private Clubs 2007

Source: Mintel 2008 and own calculations

Gyms also compete with other leisure options for non-essential spending, ranging from holidays, pub visits, and cinemas. Activities such as outdoor running, walking, or cycling also compete with commercialised offers. Health and fitness was the second-fastest growing leisure category from 2002 to 2007, after video and computer games (Mintel 2008). To maintain its competitive edge, gyms will have to extend their offerings by becoming 'coordinators' of any sort of activity e. g. walking dogs, programmes for the elderly etc. that improves people's health. The service focus has to widen from fitness to health (FIA 2009).

Consumer Survey

There are 5.5 million members in UK health and fitness clubs (Mintel 2009). As mentioned above, Virgin Active targets a wide range of consumers (from children to seniors), and believes those consumers are looking for an all-inclusive health club near their home with friendly staff. An online survey (see Table 2) conducted for this project reported that the most important

factors (a rank of “ very important” or “ mandatory”) are location, cleanliness of locker rooms and variety of equipment.

Average Survey Respondent:

Male (64%)

Aged 26-35 (57%)

Exercises at gym each week (75%)

Has been member of current gym less than 2 years (44%)

Goes to the gym 3-5 days per week (56%)

Uses the gym exercise equipment (84%)

Does not work with a personal trainer (68%)

Rarely or never buys food/drink from gym cafe (96%) Overall, survey respondents who indicated a current or previous Virgin Active membership (59) considered these characteristics slightly more important than the overall group of 196. These three factors are emphasised by Virgin Active, showing a clear understanding of what drives customers to choose a gym.

When asked why they left or changed gyms, 48% of survey respondents mentioned location, either because they moved or because it was too far away. The second most common reason was that there wasn't enough incentive (atmosphere, variety of equipment or classes) to keep them going regularly (18%). Both of these suggest opportunities for Virgin Active to

increase retention by targeting these customers, either through relocation schemes or more engaging activities.

Table 2. Health Club Customer Survey 2008

Characteristic

Survey Respondents – All

Survey Respondents -VirginActive Members

Location of Gym

89. 8%

93%

Cleanliness of Locker Rooms

62. 2%

77. 2%

Variety of Equipment

49. 2%

70. 2%

Strategy Overview

VA's vision is to become the biggest mid-market gym network in the UK and the benchmark by which all other gym networks are measured, described by the MD as " a gym of the people". (Brennan 2009)This mass-market, consumer-centric approach is typical of the overall Virgin brand position of challenging the status quo in an industry sector and improving the customer

experience. VA's strategy can be described as entrepreneurial, adaptive and emergent. This has been demonstrated in the way the business has grown rapidly both through scaling a tried and tested model and also through capitalising on external opportunities such as the take-over of Holmes Place.

To appeal to the broadest customer base, the VA gym model is an all-inclusive concept that specifies a minimum of 4,000 sq m of floor space featuring a gym, cardio area, studio, swimming pool and café. This is a key point of difference as VA is the only national gym network to offer this model in every one of its gyms. VA also markets its offering aggressively. During 2008 Virgin Active had the greatest advertising expenditure of any gym group both in total spend and in spend per member (AC Nielsen 2008).

Virgin Active is outgrowing the market by 2% a year (Mintel 2009) and providing the marketing spending remains constant we project that this will continue. This strong growth strategy is currently returning an estimated 30% return to its equity investors.

Strategy Critique

The short term view is that this is a highly successful strategy. This is a business that is outperforming the market and giving excellent returns to its equity investors, however, this is the view of Altitude 5 that this level of return is not sustainable.

Our calculations show that this is a market set to meet saturation within 3 years (measured as 15% of the adult population as gym members). In addition, VA is set to reach full utilisation within 3-4 years (during peak

times). With that in mind, the key issue here is where does the future growth come from?

New ideas are urgently needed if this business is to continue giving favourable returns to equity. Virgin Active's sustainability requires a shift in strategic focus from the current economies of scale approach to a profit maximisation approach. Profit maximisation should focus on improving both yield per member and yield per square metre.

Recommendations

To address these issues, the below strategic recommendations have been developed.

(i) and (ii): Reposition the business as a social centre. Introduce a new sub-brand - " VIRGIN HEART".

(iii): For current (and current market segment focus potential) clients alter the offering so that it provides a deeper level of social engagement and thereafter emotional engagement on the part of the members through an increased club mentality through the introduction of social directors, and by delivering further on its innovative promises by bringing technology into the gym.

Virgin Heart

Currently, this market may be intimidated by the gym offering, but the VH brand would focus on general wellbeing, happiness and social interaction. This would involve widening the current product offering so that it appeals to potential off-peak users, principally of the retired generation and

mother/child. This is a considerable segment that has not been sufficiently tapped, and whom could use the gym during off peak hours.

Whilst it is possible that the average VA member may not wish to exercise alongside the retiring population, the offering would be restricted to off-peak times, when the majority of current members would be largely unexposed. Further, their gym requirements would be different with focus perhaps being more heavily weighted on pool and exercise room rather than free weights, weight machines and running machines.

Whilst much of the equipment may not be utilised by the older (retirees) and young (mother and child) of this segment, parts of the gym which would be used would be the pool and the exercise room. Products that could be run for the retiree generation would include: ball room dancing, water aerobics/dancing, indoor bowls. Equally, the mother child segment may use the same facilities (pool and exercise room) for equivalent type activities.

VA, the new community hub

The macro effects of the successful completion of this programme would be that the gym would become more than just an exercise centre, but rather the central focus point of the community where all from the market and the local community feel a sense of belonging to a club, which has their wellbeing and happiness at its core. Arguably, no such community centre has existed since the depletion of the church. There would be many benefits to be had where any such centre could be developed where it becomes the heart beat of the community.

The anomaly at present is how a club with approximately 600 members has no real social element. Is there anywhere else (with the exception of the London tube) where hundreds of people will gather, but no social interaction occurs?

By focusing on adding a social offering to the current product, members will become more attached to their gym as it becomes a social/community interaction hub, thus increasing retention. This can be done by introducing:

Social director: Means of achieving this would be to appoint a social director whose role it is to bring the club together through sessions such as social and business networking sessions, an active role in organising club trips, club teams (football, hockey, tennis, golf, swimming etc) talks (exercise regimes or local matters of interest), dinners and events with other clubs. VA should consider the social model of a traditional club such as a football club or a golf club, with a view to transposing the social elements of these clubs to the gyms. For many members of such clubs, they will remain part of the club even though they no longer participate in the physical offering.

VA Club Captains and committees: Each VA could appoint a Club Captain and committee whose role would be to develop the sense of belonging and social aspects of the club.

Social engagements, inter-club matches, teams and trips: Sporting engagements could be arranged between the different clubs, and perhaps even quarterly sports days where various competitions. From our research we identified that when members move residence, they will not normally remain loyal to a brand, but rather select their next gym on the basis of

convenience (37% of survey respondents stipulated they leave their current provider when they move). We recommend that the social director's remit could be to assist in their relocation to ensure that they remain loyal to the VA brand. This may involve the introduction and offering of a special relocation package, where necessary, to maintain the relationship.

Increased retention through technological innovation

In a time when technology is a driving force behind so many elements of our society, we believe that opportunities exist for VA to differentiate itself in an otherwise generic market through the harbouring of technology and innovation (already viewed by VG as an important part of the brand offering but perhaps yet to be exploited).

The correct deployment of such would increase the offering to gym members and in the short term at least develop VA as the innovative gym (prior to the inevitable imitation by competitors). This should be incorporated by:

Introducing CRM to equipment usage so that VA can monitor which equipment is being used at which times. This will provide them with a full understanding of the demand placed on the equipment and customer behaviour.

Introducing "Nikerun" or "iphone" type applications/software, which could be used as an aid to workout so that the user could then upload their workout onto their home computer for a full analysis.

A VA Facebook type social network type application which could be used to broadcast news about the gyms and their offerings, and provide the

members to communicate with one another and share knowledge. This would be a development on the concept that to date has been rolled out on Virgin Atlantic planes.

Virgin tour. VA could provide a moveable offering, whether in the form of a tour bus/lorry with basic equipment and exercise space (perhaps with a core that can be manipulated to provide extra space) that could take the gym offering to people. This would act as a means of promoting the brand at large events such as music festivals. It could also serve as a positive marketing tool in taking the gym to underprivileged areas.

Conclusions

In conclusion, while VA has been successful, our analysis of VA has highlighted the following issues inhibiting its future growth: (i) obtaining new market share in the provision of a generic product; (ii) congestion during peak hours, and significant under-utilisation during off peak hours; and (iii) member retention.

To address these issues Altitude 5 has developed a strategy that could result in improved utilisation during such off peak times, Virgin Heart (VH). VH would focus on an offering whose focus it is, to move away from the traditional concept of a gym where the goal is to develop one's muscle tone, and competitive fitness, but rather more of a club environment, where the focus is on improving wellbeing, and general health (ie improving the heart).

Appendix: Research & Methodology

Primary Data Collection

Secondary Data Collection

Interviews

Virgin Active:

Peter Brennan, Managing Director

Tim Davis, Head of Marketing

Scott Hood, Head of Product

Belinda Hogan, GM Islington Club

UK Fitness Industry Association:

David Stalk, COO

Government reports:

“ Be Active, Be Healthy” Policy, UK Dept of Health 2009

Site Visits:

VA Croydon, VA Islington,

VA Clapham, VA Moorgate,

VA Hendon

VA Croydon

Competitors Analysis:

2007/8 Annual Reports, Websites

Site visits to Fitness First, Cannons/Nuffield Health, Green's, Esporta, Dulwich Leisure Centre, LA Fitness, Public Leisure Centres.

Financial Analysis:

2007/8 Annual Reports, VA UK, VA International

Industry Analysis:

" Market Re-forecasts - Leisure Pursuits (UK , " Mintel March 2009)

" Leisure Centres and Swimming Pools (UK," Mintel April 2008)

" Health and Fitness Clubs - UK," Mintel (May 2007)

Consumer Online Survey:

203 responses (90% gym members; 34% VA members; 60% male; 57% 26 - 35yo)