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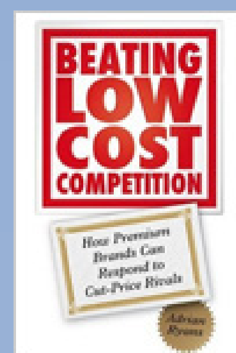
Beating Low Cost Competition

Whenever I teach pricing, there is usually one or two executives telling me that traditional pricing approaches and theories are useless. In their current market, low cost competitors are gaining market share at their expenses. Therefore, only the lowest price wins, which makes any price strategy obsolete.
While I agree that low cost competitors are gaining momentum, especially during the current crises, I am convinced that there are better options available than just cutting prices.
Fortunately, my colleague at IMD, Professor Adrian Ryans, has addressed this challenge and summarized his findings in his newest book, Beating Low Cost Competition. The following text is based on a "Perspective for Managers" publication by Adrian Ryans.

Low cost competition is here to stay

BOOKS

Beating Low Cost Competition



by IMD Professor Adrian Ryans, 2009

This book provides numerous examples of how different companies in different industries have responded to low cost competitors and analyses the effectiveness of their strategies

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In downturns, cut-price rivals with "good enough" products and services often gain market share at the expense of the premium brands. In 2008 as the UK fell into a deep recession two of the fastest growing retailers were Aldi and Lidl, the two German hard discounters. Tesco, the dominant grocery retailer in the UK, actually lost market share. A similar pattern occurred among airlines where Ryanair and easyJet clearly outpaced their full-service rivals in term of passenger growth in Europe in the final three months of 2008. Some companies comfort themselves by thinking that these losses of market share are a temporary customer response in a recessionary environment. They often are not. Many customers find during the downturn that the "good enough" solution does fit their needs. Therefore, they continue to use the cut-price supplier, even when they could afford to return to the premium supplier.

Cutting prices and costs may not be the best response to cut-price rivals.

The temptation that many premium brands fall prey to in a downturn is to cut back, cut costs and try to compete more aggressively on price with their low cost rivals. Occasionally this might be the right approach, but often it is very shortsighted and can be disastrous long term. As the competition from the cut-price rivals increases and some customers begin to defect, the temptation is to shave prices.
If the downturn lasts long enough there may be two or three rounds of these kinds of cuts or fee increases. In some cases this leaves the company "stuck in the middle" - its prices are still significantly higher than those of its cut-price rivals so price sensitive customers are not tempted to choose it.
Moreover, the customer segments that valued a high level of service and were willing to pay for it, now see service levels declining or niggling fees being added. Neither group is happy.

Customer-focused cost-cutting may work

This does not mean that cost cutting should not be entertained - clearly it must, and not just in downturns. However, customer-friendly cost cutting requires a deep understanding of customer needs by segment. The company needs to understand in-depth what aspects of the product and service solution are creating value and how much value. The company must invest its resources in those product and service features that are valued and eliminate those that are not.

Moving beyond cost-cutting - Recognize the segmentation in the market and respond to it

Other more customer-focused options go well beyond intelligent cost cutting and can generate better returns and leave the company much better positioned for the future. Dow Corning, the world's largest manufacturer of silicone products, had achieved this position by working very collaboratively with its customers to develop silicone solutions to meet their particular needs. In the early years its customers had shown a willingness to pay for the high level of support that Dow Corning provided, but during the 1990s an increasing number of customers began defecting to low-price rivals for at least some of their silicone requirements. The response was a dual pronged approach: offering a lower price option for customers seeking a "good enough" offering and upgrading their traditional offer for those customers who wanted a more complete solution and were willing to pay for it. The good enough offering is delivered from the same production infrastructure by a new Xiameter business unit. Xiameter is an internet-based business which offers a limited range of Dow- Corning's more commoditized products (less than 5% of its total portfolio) without technical support and with very strict business rules about such things as order quantities, delivery time and payment terms.

Help customers cut costs and focus on their core business

Companies that are focused on cutting headcount and costs in a downturn, are sometimes more receptive than usual to offers from suppliers may be able to reduce their costs by taking over non-core activities from them. Orica Mining Services showed strong profit growth during the last recession in part by taking over the blasting activities of many mines and quarries and charging the customers for the rock "on the ground" that met the customer's specifications. This often involved the customer transferring its blasting staff and perhaps the equipment used for blasting to Orica. This helped Orica be less dependent on selling commodity explosives and more tightly linked to its customers making it more difficult for them to switch suppliers.

Invest in product and service innovation to distance yourself from the cut-price rivals

Another group of companies recognizing that customers have unmet needs can find that a downturn is a good time to introduce new products and services that are significantly better than the "good enough" products offered by their low-cost rivals. Apple

successfully launched iPod and iTunes in 2001 and with the addition of the iTunes music store in 2003 it left the other manufacturers of commoditized MP3 players in the dust. Downturns are often good times for launching new products where heavy advertising and promotion outlays must be made to build customer awareness for the new product.
When markets are booming companies are reluctant to take capacity out of profitable production for this kind of testing activity. In a downturn, production lines are often sitting idle, making it a perfect time to test new products.

(c) photo by aaadvark

Mass-Customization: Segmentation Matters

In a recent paper, based on Michael Kreuzer's dissertation, we studied the willingness-to-pay for mass-customized products.
Through mass customization, firms can offer individualized products at little additional cost, which has prompted extensive research into the supply side but less investigation of consumer attitudes.
Customers' willingness to pay more for mass-customized products may depend on their desire for unique products and use of such products in their self-presentations. It also may reflect their avoidance of the negative attributes of standardized, off-the-shelf products. These positive and negative motivations do not necessarily correlate, which suggests a segmentation approach.
In addition to these main effects, the proposed model includes suggested antecedents derived from extant literature. In tests of the conceptual model, a large sample of real-world consumers confirm the main hypotheses, indicating the existence of four customer segments, each with a distinct attitude toward customized products.
- customers who buy mass-customized products because of their uniqueness

- customers who buy them in order to avoid off-the-shelf products
- customers who buy them for the combined benefits of uniqueness and avoidance of standard products
- customers who are not willing to pay any premium for mass-customized products.

Source:
Michel, Stefan, Michael Kreuzer, Richard Kühn, Anne Stringfellow, and Jan Schuman (2009), "Mass-Customized Products: Are They Bought for Uniqueness or to Overcome Problems with Standard Products? (Forthcoming)," Journal of Customer Behaviour, 8 (3).

The full article will be available in Fall 2009 at the journal's
website .

Managing beyond Web 2.0 by McKinsey

It's hardly news that the Internet has evolved into the primary vehicle for communication, information, and commerce. But in a surprising twist, today's online customersas both producers and consumers of their own content and servicesferociously guard their online experiences. This trend, which goes far beyond Web buzz, is catching some executives by surprise and making others more than a bit worried.
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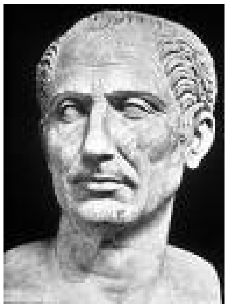
Latin for Managers, Lesson 4



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