

IS COST A COMPETITIVE ADVANTAGE OR A POINTER TO ONE?

A. Marketing Strategies in a Me-too World

An organisation exists through its products (and services) and price is an important facet of a product’s personality. It is also happens to be one of the 4 traditional Ps of marketing; subsequent additions having seen the inclusion of Profit, to factor in the dynamics of modern business practices. This article confines its remit to markets operating on a cost-plus pricing strategy¹.

TABLE 1: MARKETING PS	
Traditional	Additional
<ul style="list-style-type: none"> • Product • Price • Place • Promotion 	<ul style="list-style-type: none"> • Profit • People • Process • Promise

In a world of accelerating technology creep, and the impact of this development on the cost of production of goods, is cost any more a competitive-advantage? In a Me-too product (and marketing) strategy, a non-pioneering company’s instinct, typically, is to offer the same feature-set at a lower price than the offerings of market leaders.

This may not be all of a bad thing in the services sector, where competitive advantages accrue with experience (being primarily process driven). Amongst products companies, though, such a price-led marketing strategy does not have to be the de-facto decision. An organisation can adopt a “Me-too & More” strategy as an alternative to a “Me-too, Price-driven” strategy. The “& More” can be any or many of the **core functions** of IP, processes, people and technology practices (where IP refers to the product idea and technology to its manufacturing).

Therefore, should not a cost advantage rather be viewed as a potential strength in a core function?

B. The Limits to a Price-driven Strategy

There are two points to note, insofar as a price-driven strategy is concerned.

In the first place, an important characteristic of a price-led marketing strategy is that all markets have a saddle-point at which a more competitive price does not necessarily translate to higher market share. This inelasticity in price sensitivity (as indicated through brand purchase patterns), implies that at the most competitive price bands, product brands sell on a whim (of the buyer) and a prayer (on the part of the seller).

A schematic, using the atomic structure as a basis, provides a visual representation of the dynamics of product brands and the value bands they occupy (see Figure 1 below):

¹I shall use the word “Price” when the discussion is in the context of the “market”, and the word “Cost” when the discussion is in the context of the “organisation”. For the purpose of this article, both words may be used interchangeably (i.e. the context for the discussion is a mature market, where vendors do not indulge in predatory pricing) – although this need not be so in other situations.

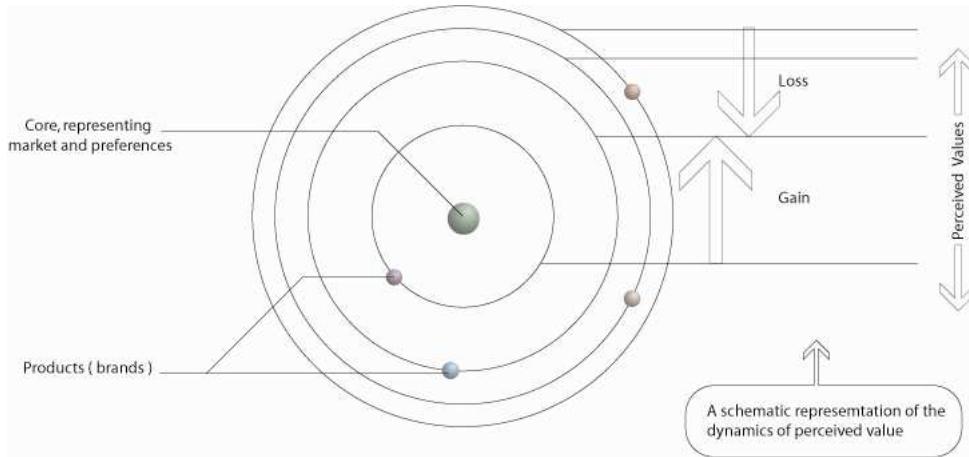


FIGURE 1: A SCHEMATIC REPRESENTATION OF THE DYNAMICS OF PERCEIVED VALUE

Note:

- *The core represents the market and its (consumer) preferences.*
- *The bands represent “perceived value” (a combination of brand equity and price) of the product/product line/brand, in the target market. It is implied that there is a positive correlation between “perceived value” and “market-share”.*
- *Occupying a band closer to the core indicates a higher perceived value for the brand (core players), as well as a higher ratio of brand equity (to price) in the “perceived value” equation.*
- *There is an increase in the representation of the price component, in the “perceived value” equation, at bands farther away from the core.*
- *Bands get closer in proximity to each other, the farther they are from the core; signifying that it is easier for the occupying brands (fringe players) to move between these bands (as dictated by consumer demand).*
- *Progression to bands closer to the core is dependent on the appreciation (or gain) in the “perceived value” of the brand; while a falling away from the centre signifies a loss of perceived value.*
- *The energy of movement (of the brands) within the model is dependent on the nature of the market (maturity, complexity, and operating environment).*

Secondly, the law of diminishing returns applies to a price-led strategy too: which is that, improvements in process and technology deliver smaller and smaller cost advantages and, therefore, price corrections. So much so that, any further “significant” cost advantages will only accrue at the expense of enormous efforts in improving processes and technology.

C. “Me-Too, Price-driven” or “Me-Too & More”?

Or, how does an organisation decide on which marketing strategy to pursue?

Let’s be clear: market communications-wise, if there is a price advantage to talk about, it is the easiest to walk-the-talk to. There is a resonance that a price pitch sets off amongst customers – provided the advantage is perceived to be significant. To an organisation looking to build an overseas market, perforce, it may seem the only pitch. However, such a move may be a reflexive response, or at the most a short-term response, to market stimuli. A detailed analysis may well reveal the transience of the benefits of a price-led marketing strategy.

In which case, how do we deconstruct a cost advantage into its constituent drivers? One way to do so is to work out the relative strengths of the four core functions (mentioned earlier) in the cost equation. Values, for the core functions, can be arrived at by rating specific criteria under each core function on a scale from 1 to 10, and adding them up to reach a consolidated score for each function. A cursory analysis will then reveal the strongest variable in the cost equation.

The criteria and the direction for scoring (i.e. is more of the criteria more on the scale of 1 to 10, or less) are displayed in the table below:

TABLE 2: CORE FUNCTION RATING

Core Function	Criteria	Scoring Direction
Intellectual Property	<ul style="list-style-type: none"> ▪ Maturity of market ▪ Criticality to product ▪ Estimated timeline for competitors to match/move ahead ▪ Estimated volumes to recover cost of IP 	<ul style="list-style-type: none"> ▪ → ▪ → ▪ → ▪ ←
People	<ul style="list-style-type: none"> ▪ Knowledge level of core skills (median across workforce) ▪ Cost of retention of core skills (median across workforce) ▪ Scarcity of core skills (across industry) ▪ Profile of organisation (relative to competitors) 	<ul style="list-style-type: none"> ▪ ← ▪ ← ▪ ← ▪ →
Processes	<ul style="list-style-type: none"> ▪ Speed of evolution (relative to industry) ▪ Impact on quality ▪ Impact on productivity ▪ Impact on innovation 	<ul style="list-style-type: none"> ▪ → ▪ → ▪ → ▪ →
Technology Practices	<ul style="list-style-type: none"> ▪ Contemporariness (relative to best in industry) ▪ Percentage of cost depreciated ▪ Cost of succeeding technology (including implementation and re-skilling) ▪ Time required to implement roll-over technology 	<ul style="list-style-type: none"> ▪ → ▪ → ▪ ← ▪ ←

As a more detailed exercise (with a visual output), one can take the consolidated scores for the core functions; weight them as per a tenuous/tenacious index, based on the vertical²; and add up the resultant numbers to arrive at the stickiness coefficient for the cost advantage. Carry out a similar exercise for the top 2 – 3 competitors, the bottom 2 – 3 competitors, and 2 of the closest competitors. The final piece of data is the “goodwill” associated with each company; which will be a number ranging from 1 (no goodwill) upwards, on a logarithmic scale (a rough-order quantitative basis for which can be the promotion budget for the company/product).

First, map the products / product line onto a grid (based on market-share and price-ranking parameters), as illustrated in Figure 2 below. Market-share data can be picked up from third-party sources while price-ranking can be worked out as a standard deviation function (Z-score standardisation or Inter-Decile Range Standardisation), from the lowest priced product.

²The weightage, given to each of the core functions (IP, people, processes, and technology practices), will vary depending on the vertical. For example, the weightage given to the core functions for an engineering (manufacturing) entity may be 50%, 10%, 10%, and 30% respectively; while it may be 70%, 10%, 10%, and 10% respectively, for a pharmaceutical company. This index can be created based on the relative strengths of each of these core functions, as competitive advantages, in the vertical.

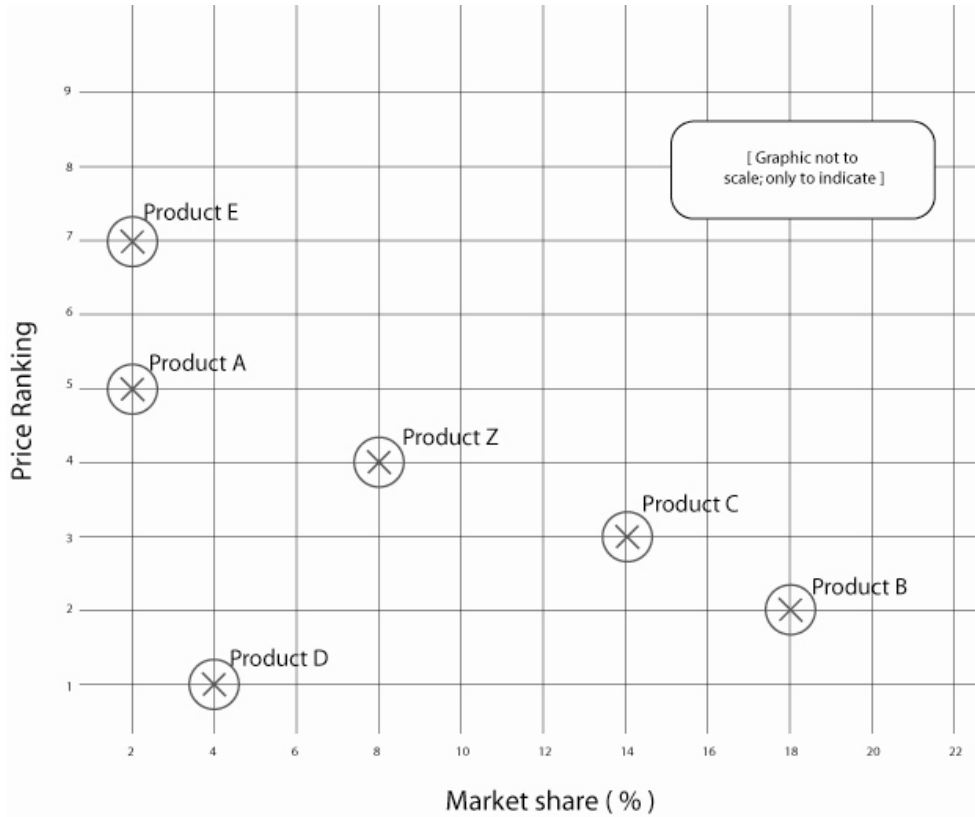


FIGURE 2: PRODUCT MAP BASED ON MARKET-SHARE AND PRICE-RANKING PARAMETERS

Now, include the stickiness coefficient and the goodwill factor for each product (or product line) as a density function at each co-ordinate. A 3-dimensional grid will form; looking rather like an undulating (and difficult) green on a golf course (see Figures 3 and 4 below).

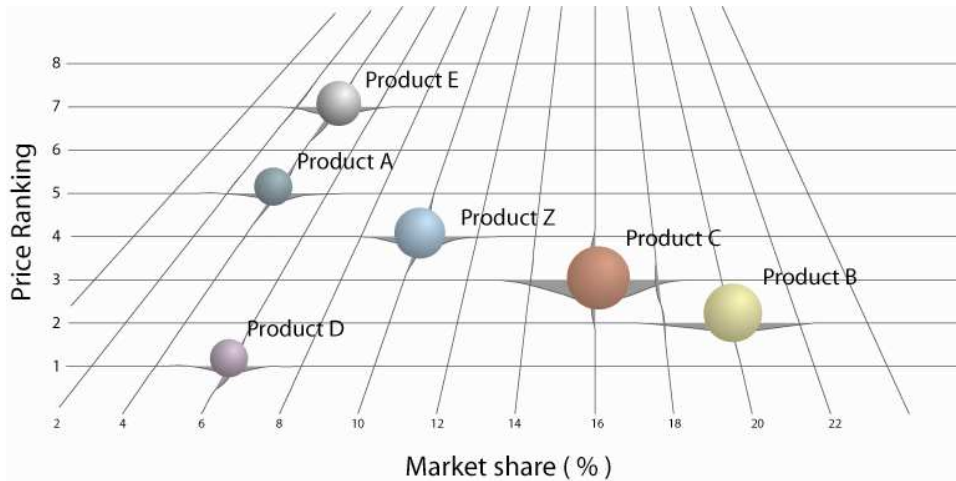


FIGURE 3: PRODUCT MAP WITH ADDITIONAL PARAMETERS (STICKINESS CO-EFFICIENT & GOODWILL FACTOR)



FIGURE 4: PRODUCT MAP WITH ADDITIONAL PARAMETERS (ORTHOGONAL PERSPECTIVE)

The graph can be animated by tracking market share over a couple of past quarters; or by extrapolating changes in the price differential or the stickiness co-efficient/goodwill factor, to changes in market share (see Figures 5 and 6 below). The grid may also be imbued with properties such as market characteristics (volatility of customer brand preference, price elasticity, etc.) to further refine animations.

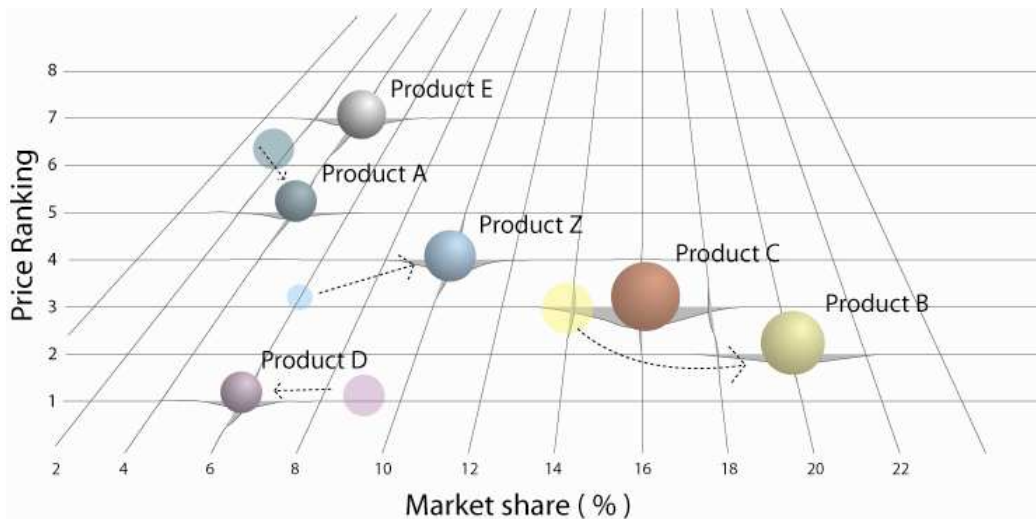


FIGURE 5: TRACKING MARKET-SHARE CHANGES OVER A COUPLE OF QUARTERS

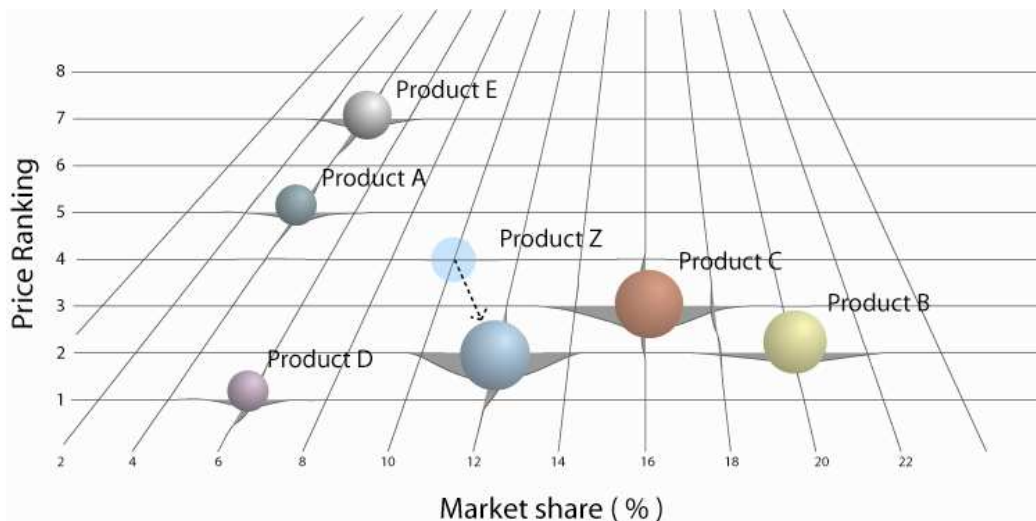


FIGURE 6: SIMULATING CHANGES IN MARKET-SHARE BASED ON CHANGES IN OTHER PARAMETERS

An analysis of the grid will now reveal:

- The product's / product line's actual positioning in the market
- Relative positions of competing products
- Susceptibility of product/product-line to competitive pressures
- Opportunities for increasing market share, based on open or exploitable spaces on the grid
- Scenarios based on simulating changes in the environment (either pricing or product or perception)

Based on the above analysis, a decision may be taken in favour of:

- A “Me-too, Price-driven” strategy
- A “Me-too & More” strategy
- An execute a “Me-too, Price-driven” strategy, and communicate a “Me-too & More” message
- A “Me-alone, Price- premium” strategy

D. The China Syndrome (amongst Indian businesses)

These days, any discussion on markets, business competitiveness and growth is parenthesised by the China Syndrome; “low-cost goods” generating units (thankfully not in Services just yet, so the software services and ITES industries have some breathing space), with enormous “manufacturing capacity”.

Organisations, nowadays, are asked to focus on cost; and rightly so. The days of putting up with organisational flab and slack ended with the opening up of the economy: productivity and response time are the key metrics of this new age. However, an unwavering focus on cost reduction may end up in the baby being thrown out with the bathwater.

Yes, an organisation should constantly benchmark its cost structures and product costs against the best in the industry in the country and abroad. However, that's all cost should be: a criterion against which to calibrate the efficiency of the business. Once benchmarked, the gap between industry-best costs and the organisation's costs needs to be bridged by building on the core functions.

What works for one organisation, operating in a specific environment, need not necessarily work for a same/similar-business organisation, operating in a different environment. A manufacturing company based out of an EPZ in China may benefit from advantages arising from production volumes (economies of scale, quicker amortisation of IP and technology costs, etc.), but suffer from an inability to cater to low volume, bespoke specifications. An Indian competitor may, therefore, decide to work on the “technology practices” and “people” core functions of its business, to cater to that potential business opportunity.

Conversely, the same Indian competitor – busy exploiting a cost advantage vis-à-vis a Chinese EPZ-based manufacturing company, when fulfilling low-to-mid volume bespoke specifications – needs to calculate the stickiness co-efficient of its cost advantage. Accordingly, the organisation may steer towards a premium pricing strategy in order to channel the additional profits, thereof, towards creating IP or rolling over production technology, or improving processes, or developing human resources.

One organisation's cost advantage is another organisation's business opportunity; and, an organisation's cost advantage may also be an opportunity to leverage potential strengths in its suite of core functions (to generate higher profits). After all, one may do well to note, relief from discomfort should not be confused for a cure for the discomfort; a cost advantage is almost always a relief, not a cure.