Commodity Products: is there an alternative to selling on Price?

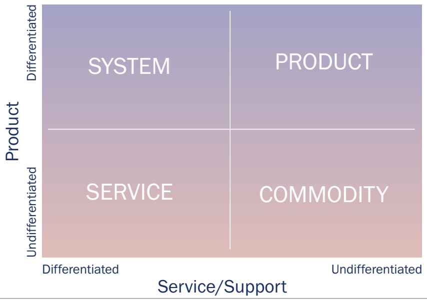
How do companies compete in markets for basic, undifferentiated, commodity products? Traditionally, competitive advantage has been based on Porter's[1] assertion that market leaders are either the best on cost or the best on differentiation. Which strategy is most appropriate depends on the nature of the market. For Apple it's differentiation through innovation but conventional wisdom is that in commodity markets the most efficient, low cost producers will win the day. Alternatively, in the ground-breaking words of Theodore Levitt[2] back in 1980,

> the way a company manages its marketing can become the most powerful form of differentiation. Indeed, that may be how some companies in the same industry differ most from one another

Of course, Levitt wasn't talking about marketing in terms of superficial activities such as advertising and branding but was referring to the real function of marketing, which is to meet customers' needs. However, even the marketing literature often capitulates when it comes to undifferentiated products, referring to transactions as 'straight rebuys' with buyers exhibiting 'routinised response behaviour'. Buyers are said to see competing products as the same in terms of quality and performance, to feel that they need little or no information to make a good choice and therefore to be very comfortable buying solely on price. A cursory look around world markets would often support this view, not just for out and out commodities such as steel but for many higher added value manufactured goods such as textiles or even computer chips. Many people claim this to be the reason why British manufacturers can't compete – high wage rates making it impossible to be the lowest cost producer. But it's contradicted by the Leigh Paints story (see page 8).

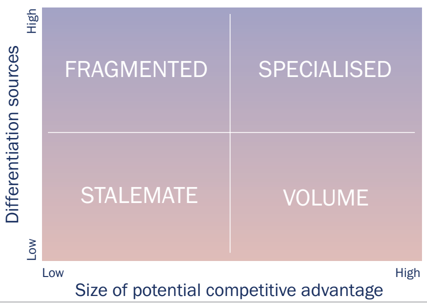
Marketing academics such as Mathur[3] have suggested alternatives to price-based industrial strategies as shown in Figure 1. If buyers are offered absolutely no differentiation on the product or the service, it really is a 'commodity' and it would be irrational to base purchase decisions on anything other than price. 'Products' are goods that can be differentiated in some way, perhaps through innovation, quality or durability. But if they really can't, differentiating the support or the customer service can effectively turn them into 'services', and the best strategy is to communicate differentiation on the product and its support, and selling a 'system'.

Figure 1: Generic competitive strategies



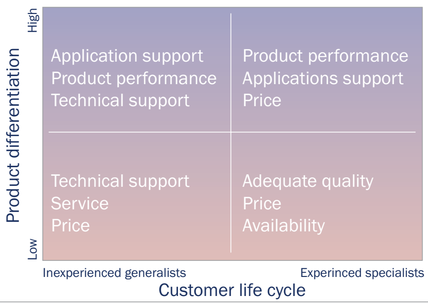
However, even Mathur was pessimistic about industrial companies' ability to stick around in the top left box, identifying a 'transaction life cycle' where products automatically move from system to commodity. This was defined even more starkly by the Boston Consulting Group[4] with its term 'stalemate industries' to classify markets that are simply devoid of competitive advantage opportunities, as illustrated in Figure 2.

Figure 2: BCG competitive systems



DeBruicker and Summe[5] looked at this issue from the customer perspective, identifying a customer life cycle. As products become more mature and less differentiated, customers become more experienced and, consequently, more discerning buyers of the product. Illustrated in Figure 3, the concept is best understood by imagining the customer life cycle for a specific product such as a computer. The starting point is a first time computer buyer – an inexperienced generalist, who is likely to take a long time to reach a decision, placing great value on supplier information, advice and support. Due to the high perceived risk of the purchase, senior management are likely to feature more prominently than normal in the DMU (decision making unit). The closer the product type is to the beginning of its life cycle, the greater the uncertainty will be since the early adopter customer is unlikely to know other users so is more dependent on the supplier. As customers gain familiarity with a product over time, their confidence as users and buyers grows so the perceived value of suppliers' support programmes begins to decline. They will be less likely to look for a comprehensive bundle of benefits since "the bundle's components can be analysed, sorted and valued" by the increasingly experienced and confident customer.

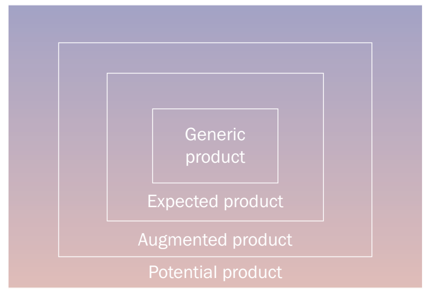
Figure 3: Strategies for customer life cycles



The strategies DeBruicker and Summe recommend for the early stages of the customer life cycle focus on account management, adding value, emphasising service and support and keeping the debate away from price. Ultimately, however, they fall in line with the previous theories, maintaining that the combination of customer and competitor forces produces a mature market where buyers become experienced specialists who are concerned only with adequate quality, availability and price. Even so, the customer life cycle does offer sellers of undifferentiated products more hope for adding value because an individual customer could be a late adopter of a mature product and therefore an inexperienced generalist. It is always worth devoting a lot of time and effort to identifying organisations or individual DMU members who might be in this position even if your product and market are well into maturity.

Theodore Levitt[2], however, says that "there is no such thing as a commodity." It is true that to be a steel stockholder, you must have steel to sell but "the generic thing is not itself the product; it is merely, as in poker, table stakes; the minimum that is necessary at the outset to give the producer a chance to play the game." Levitt maintains that what matters is how you play the game because customers will always require more than just the generic product at the best price. Illustrated in Figure 4, Levitt defines the 'expected product' as the customer's minimal purchase conditions, which will include various quality and delivery requirements and may extend to before- or after-sales support. These conditions are the industry norm and will therefore be met by the large majority of suppliers in the market.

Figure 4: The total product



To differentiate itself from competitors, a supplier may offer the customer more than he expects – 'an augmented product'. This could be innovation, product variants, flexibility to tailor products or service to exact customer needs, financing, consultancy services to improve the performance of the customer's organisation, and many other enhanced benefits.

There are two problems with the augmented product. First, today's augmented product can soon become tomorrow's expected product. For example, 20 years ago just-in-time delivery was a great added value benefit. Now, many large manufacturers have transferred stock holding costs almost completely to their component suppliers and it's no more than 'table stakes'. The second issue is that the added value perceived by the customer must exceed the added cost incurred by the supplier and this can be quite a challenge in markets for undifferentiated products with a very narrow price band.

But Levitt argues that unless suppliers of undifferentiated products are prepared to

rely on price competition alone, they simply have to find ways of augmenting their offering. The problem is identifying the best way to do so. It's here that Levitt moves into the realms of the 'potential product', which, basically is anything that could be offered to customers. It's the role of management to identify the best way to add value in customers' eyes. It may be enhancements to the product itself or value added services that bear little direct relationship to the core product or service. The essence is that it's superior customer insight that enables management to succeed in this task. Ironically, customer insight has often been embraced more extensively by suppliers of high added value items such as cars, but in reality, it's suppliers of undifferentiated products that need it most.

Adding value to cement

You can't get much more undifferentiated than cement. This is a message that wasn't lost on Lorenzo Zambrano, CEO of CEMEX, based in Mexico and the third largest cement producer in the world. Quoted in the Value-Profit Chain[6], Zambrano says:

> **Who wants a sack of cement? You want a home or a bridge or a runway.**

He has implemented the total product concept, focusing CEMEX on delivering results to customers to add value to an undifferentiated product. To implement the strategy a paradigm shift in management behaviours was essential, moving from command and control to "consulting and cheerleading." Empowering employees enabled the company to remove layers of management reducing cost and improving performance at the same time.

Zambrano encourages customers to help him continually challenge CEMEX employees to come up with new ways of delivering results to customers, enabling Cemex to improve the performance of its customers' businesses. An example was the pledge to always deliver ready-mix within a 20 minute time window even in the congested streets of Mexico City and Monterrey. Not bad for a product that can be delivered in 8,000 different combinations with a shelf life of only 90 minutes on the back of the lorry. Going a step further, the company's new web-based inventory management system manages customers' stock levels for them, enabling customers to focus on their construction projects, without worrying whether there's sufficient cement in their silos. In other words, CEMEX is selling its customers building capability rather than cement.

Customer relationships and rewarding loyalty are also crucial to adding value. Cemex believes that loyalty happens by design, not by chance so it is constantly communicating with customers to identify effective ways to build lasting customer relationships. Its local training programs, for example, help customers to improve their construction skills and better manage their businesses. Also, frequent-buyer programmes enable customers to accumulate points for computers and capital goods such as forklifts and light trucks. All of these value added enhancements move the focus away from the commodity, away from the price and onto the total product. S

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