Business Horizons (2015) **58**, 87—97

Available online at www.sciencedirect.com

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How to compete effectively against low-cost competitors

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KEYWORDS
Low-cost competition;
Good-enough products;
Fighter brand;
Fighting brand;
Business strategy;
Price competition;
Entry barriers

Abstract Unlike older models of low-cost competition that were based on economies of scale, many new low-cost competitors have been able to be efficient at smaller sales levels due to a combination of the following strategies: producing 'good enough' products that provide extreme value by eliminating services that cost more than they are worth to consumers, utilizing simple business models, reducing research and development expenditures via joint ventures or through purchasing technology from bankrupt firms, using price cutting to drastically expand the market for a company's goods and services, and having an organizational culture that stresses frugality and efficiency. This article explores the low-cost strategies of Aldi, Vizio, and Southwest Airlines to identify common elements. Four strategies that established competitors can use to respond to low-cost competition are presented: (1) waiting and watching, (2) deciding not to match new competitors' price levels, (3) matching or coming close to low-cost competitors' price levels, and (4) developing a new fighter brand or private label brand to be sold along with a company's traditional brands.
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1. Introduction

The traditional model of low-cost competition based on economies of scale gave established firms the advantage of lower production and material costs due to their high market share. In contrast, many low-cost competitors are now smaller firms that have lowered their cost structure due to a combination of the following strategies. Some new competitors produce merely 'good enough' products that provide extreme value by eliminating services that cost more than they are worth to consumers. Others use simple business models. In certain industries, new firms have reduced research and development expenditures via joint ventures or through purchasing technology from bankrupt firms. Price cutting is another means to drastically expand the market for a company's goods and services. Lastly, many low-cost competitors maintain an organizational culture that stresses frugality and efficiency. Low-cost entrants that have successfully challenged traditional competitors can be found in such industries as premium California wines, flavors and fragrances, IT services, open-source software, pharmaceuticals, intercity bus transportation, electronics, airlines, and retailing (Ryans, 2010b).

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0007-6813/$ — see front matter © 2014 Kelley School of Business, Indiana University. Published by Elsevier Inc. All rights reserved.
http://dx.doi.org/10.1016/j.bushor.2014.09.002

Three factors can be used to explain how low-cost firms have entered traditional markets: deregulation, globalization and outsourcing, and technological innovation. Deregulation has opened up markets to new competitors in such markets as air travel, telecommunications, and financial services. Globalization of production has reduced labor, material, and environmental compliance costs. Lastly, technological innovation as a result of research and development has provided new low-cost competitors with significant cost advantages over existing firms. Let's further examine the impact of these factors.

Deregulation of air transportation markets in the United States (1978) and Europe (1997) has spurred new competition from such low-cost competitors as Southwest and ValuJet in the United States and Ryanair in Europe. Many of these discounters have been able to reduce their initial capital requirements by purchasing and/or leasing older aircraft. In addition, because the personnel are non-unionized, these low-cost airline startups have been able to pay pilots and crew members below market salaries. Furthermore, these new competitors typically have reduced their operating expenses by flying into smaller airports with low landing and take-off fees.

To become more competitive, firms in other industries have copied the strategies of successful new competitors in deregulated industries such as the airline industry, the telecommunications industry (deregulated in 1996), and financial services (deregulated in 1999) by:

- selectively reducing service levels to cut costs on services that consumers are willing to forgo in exchange for low prices;
- restructuring traditional business models in innovative ways to drastically reduce operating costs as well as capital requirements;
- competing on the fringe of established competitors' markets to avoid direct retaliation; and
- using price cuts to drastically expand the market for a good or service.

As a result of globalization and outsourcing, many low-cost competitors have started in rapidly developing economies such as Brazil, Russia, India, and China. Low-cost imports have high market shares in a number of industries including cement, textile equipment, home appliances, furniture, and communication equipment (Bernard & Koerte, 2007; Ryans, 2010a). Many traditional U.S.-based firms have found it difficult to compete against these low-cost competitors due to their relatively high labor costs as well as the high cost of meeting regulations relating to worker safety, emissions, and other legislative requirements.

Technological innovation is a third element that has enabled global competitors to deliver variety at a low cost. According to researchers, Chinese competitors have been particularly skillful in leveraging their lower labor costs by applying world-class research and development resources to ordinary products (Zeng & Williamson, 2007). To reduce the costs of entering the communications market, Huawei, a leading global information and communications technology [ICT] provider, tried to buy 3Leaf Systems, a bankrupt networking hardware startup, for $2 million in 2010. This acquisition would have enabled Huawei to acquire 3Leaf's technology at a low cost instead of developing the technology on its own (Cody, 2012). However, the U.S. government's Committee on Foreign Investment (CFIUS) blocked the purchase. To avoid potential problems with future U.S. acquisitions being approved by the U.S. government, Huawei is now seeking to acquire firms in Canada, Israel, and China that own valuable cloud and information communication technology (Cody, 2012). Similarly, Haier, which is now the world's best-selling home appliance brand, was able to avoid costly research and development investments through licensing technology from Liebberr, a German manufacturer of premium-quality refrigerators, and through joint ventures with Mitsubishi and Merloni, an Italian appliance manufacturer (Khanna, Palepu, & Andrews, 2012).

This article seeks to appeal to new and existing low-cost competitors as well as incumbent firms. Low-cost competitors will benefit by becoming aware of additional sources of low-cost production and marketing and by being better able to anticipate the timing and range of incumbent marketers' competitive responses. Incumbent marketers will understand that their previous strategies based on economies of scale may be vulnerable as new competitors can be on a different cost curve. Incumbents will also gain insight as to which products and markets are most vulnerable to low-cost competitors, as well as how to select and implement the most appropriate competitive response.

2. Understanding which firms and products are particularly vulnerable to low-cost competitors

Mature industries and products offered by mid-quality-range firms are particularly vulnerable to low-cost competitors. Many mature industries are characterized by low research and development

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