How to respond to low cost competition
A Case Study

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ABSTRACT

Today many large corporations are facing new competitors that develop “good enough products” to a low price. Premium corporations are having a hard time to decide what strategy to use when responding to these growing competitors. By studying how companies in the B2B manufacturing industry have responded to direct low cost competition a normative model has been developed to support companies with the choice of strategy. The developed model presents descriptive factors that affected the choice and outcome of the strategy chosen. What is interesting to note is that none of the case companies transformed itself to a low cost player and used a low cost strategy.

1. INTRODUCTION

Many large corporations in Europe, North America and Asia are facing new competitors that develop good products to a low price. Premium companies often struggle to react to these new low cost competitors and new market structure. Low cost competition has seemingly been around forever, but now it seems to emerge across new industries and new product categories much more rapidly than in the past. The quality of the products and services from new low cost rivals are about to reach levels that are "good enough" for significant segments in the overall market.

Managers at traditional premium corporations are having a hard time to decide what strategy to use and how to implement it, while this change in the business landscape occurs. By studying how other companies have responded to these threats, a normative model has been developed to assist in the choice of strategy.

2. RESEARCH QUESTIONS AND RESULT

Research Questions
With the intent to assist premium companies in what strategy the companies could use against its low cost competitors, the following questions were answered:

• What strategy could a company use against low cost competition?
• Which factors caused the case companies to take action?

The strategies were identified on a general level and categorized as a differentiated, dual or low cost strategy described by Porter as generic strategies\(^1\). The result was visualized in a normative model (see Figure 1) with the different strategies on the x-axis and the consolidated factors that was descriptive for one or several case companies.

<table>
<thead>
<tr>
<th>Factors</th>
<th>Primary Strategy</th>
<th>Differentiation</th>
<th>Dual Strategy</th>
<th>Low Cost</th>
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</thead>
<tbody>
<tr>
<td>Commoditization</td>
<td>x</td>
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<td>Knowledge within the industry</td>
<td>x</td>
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<td>Customer Relationships</td>
<td>x</td>
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<tr>
<td>Economies of Scale</td>
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<td>Evolving customer segments</td>
<td>x</td>
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<td>Successful competitor moves by low cost player</td>
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<tr>
<td>Brand Awareness</td>
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<td>Timing</td>
<td>x</td>
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<td>High competition in one target segment</td>
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<td>Consolidation</td>
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<td>Deep knowledge about customers</td>
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<tr>
<td>Superior Product</td>
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Figure 1. The Developed Normative Model

A company could use this model as support when making decisions on how to strategize against low cost competition.

How to Interpret the Model
According to the model the company should use a differentiation strategy as a response to the low cost competitors if the company foremost identify itself with the following factors that the company possesses (see figure 1):

• Extensive “Knowledge within the industry”
• The industry is heavily dependent on strong “Customer Relationships”
• If the company has a “Superior Product” compared to its competitors.

Otherwise the company should use a dual strategy.

The Model Supports Existing Research
One of the objectives in the study was to test the hypothesis of the criteria for not being stuck in the middle stated by Michael Porter are true for the case companies utilizing a dual strategy and if their actions were consistent with Kumar’s framework.

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Michael Porter (1985) argues that a firm can achieve a dual strategy in the same market if one of the following three conditions is fulfilled, otherwise the company will be stuck in the middle:

1. Competitors are stuck in the middle

2. Cost is strongly affected by share or interrelationships

3. A firm pioneers a major innovation

The cases in the report support Porter’s strategy theories about being successful utilizing a dual strategy, and shows that the findings in the analysis are consistent with existing research. The actions taken by the companies were consistent with Kumar’s Framework.

3. METHOD

The Research Design

The research was conducted as a descriptive and normative case study. The reason for choosing that method was that not much research exists in the field of how to respond to low cost competition. Six different case companies were part of the study; Aer Lingus, Dow Corning, Electrolux, Orica, SKF and Tetra Pak.

The Research Process

The research process is summarized in figure 2 below, which is an adaption of the Yin Case study research process.

Figure 2. The Research Process

Case Studies

The data collected for each case company, a description of how the case studies were conducted and the analysis, was done aligned with the process in figure 3 below. This include what strategy the companies used and what factors that were descriptive for them and their environment.

Figure 3. Data collection protocol/process and how the case studies and the analysis were conducted.

How to Measure Success

It was essential to measure how the actions taken in order to respond to the low cost threats affected its entire business. In the study this was measured through operating / net profit margin before and after the actions taken. To make sure it was not just an economic boom and all companies in the industries thrived, comparisons of the industry average or a comparison with the closest competitors was also carried out.

4. CONCLUSION

Is the definition of a low cost competitor still true? Often a low cost company is associated with a low price and poor quality. Previously you could not expect to get good performance, appealing design, innovative features or great quality from a low cost player. Today everything is moving faster, production cycles are getting shorter, and so might even “market cycles”. The low cost players today are more sophisticated and are capable of delivering good enough value. They have stronger brands and are better at communicating their value. In relation to this, the customer behaviour has changed and is more receptive towards low cost companies and good enough products. It is probably not a coincidence that many new competitors are coming from Asia. They are innovative and hungry and you can no longer anticipate that their products are lagging; in some industries they are actually driving the development. This is a crucial insight to take into account when strategize against them and it is important to understand that a low cost competitor CAN compete in the high end of a market.

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