Low Price or Value Approach?

Competitive Advantage in the Global Market

Falk O Petersdorf Sri Lanka – German Private Sector Program

Common belief is that there is only one way for companies in developing countries like Sri Lanka to succeed in international competition: Offering standard products at the lowest price possible.

The abundance of cheap labor in many southern- hemisphere societies is the big blessing for the global market today, reducing production costs of labor intensive goods to minimum levels. Providing expensive high-quality goods, machinery and services seems to be an unquestioned right reserved for the high-tech nations in Europe, the USA, and Japan.

That is the simple way of looking at the global economy. It was a successful role model in the past. Yet, the future has a lot more to offer for companies in developing countries.

The Concept of Competitive Advantage

Competitive advantage is often misunderstood as simply being able to deliver a certain product at a lower price than competition. But this is only one side of the story. Competitive advantage really has a second dimension to it, which is the value of an offering.

Many well-known companies base their competitive advantages on specific values, which they offer to their customers. Mercedes-Benz’s main reason for success, for example, is the unique value of an exclusive image that the car manufacturer conveys to its customers. Caterpillar, manufacturer of heavy construction equipment, offers an unmatched service of delivering any spare part anywhere in the world. within 24 hours, therefore reducing expensive stand- stills of the customers’ machinery. The reason for the success of Microsoft is to have created a worldwide standard for computer software, which offers the ease of system compatibility for companies as well as private persons.

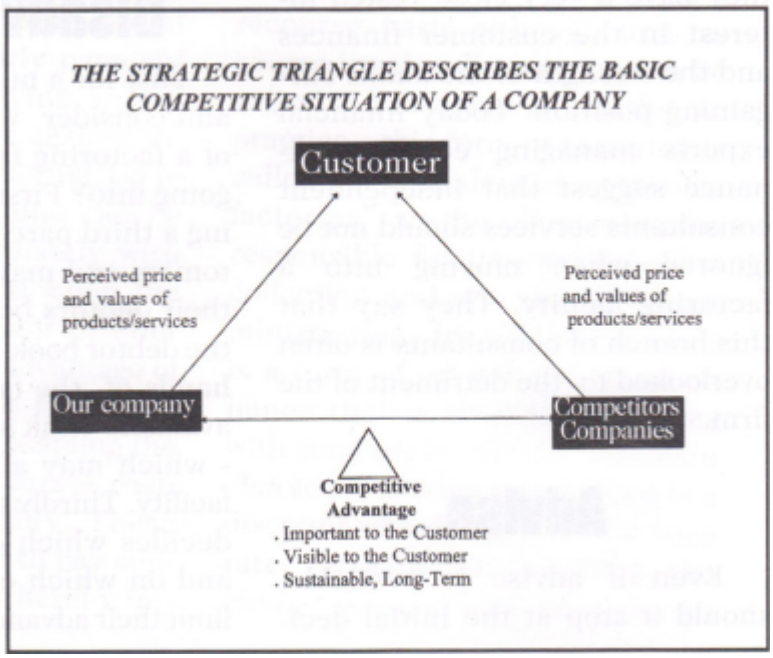
What do these three examples of sustained competitive advantage have in

common? They all concentrate on a competitive parameter which is:

(1) important to customer (24 hour Service of Caterpillar)

(2) visible to customer (The Image of Mercedes-Benz)

(3) sustainable long-term (The worldwide standard of Microsoft) The Strategic Triangle visualizes the competitive situation that every company has to face in the market-place:



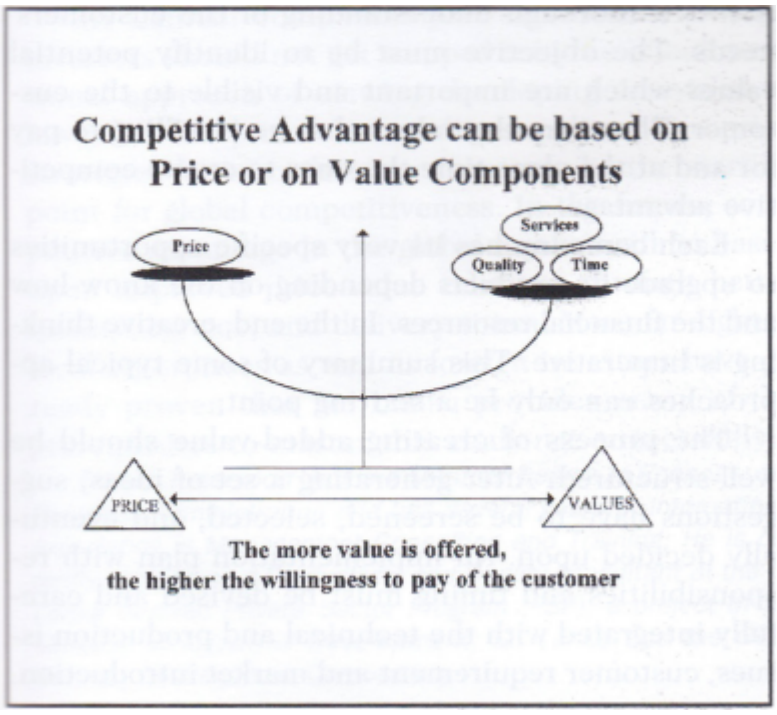
Only important features of the offering are relevant decision criteria for the customer’s buying decision. In this context, importance must be described in relative terms. The type of wheels are a very important feature when looking to buy a car. Yet, compared to the reliability of the engine, the type of wheels become negligible in the eyes of a customer. Therefore, reliability of the engine is a parameter, on which a car manufacturer can build competitive advantage, the type of wheels are not.

‘But we have the best product of all, sighs the talented engineer of a slow-selling washing machine. His personal conviction does not automatically mean success in the market-place. Unless a product feature is made visible to the customer and therefore perceived as a true value, it will not judge the product superior. Visibility can be reached by a convincing marketing campaign or a product comparison test

conducted by an independent institution. Only then, the best offer gets its competitive edge.

The enemy learns quickly. As soon as one supplier introduces a new product or feature to the market, a competitor will try to match it. Things that are easy to make often are just as easy to copy and therefore are not suitable for competitive advantage. A fancy color on a household appliance may attract the attention of a housewife but will not remain a unique feature for a long time. On the contrary, increased durability of the appliance due to the use of an innovative plastic compound is based on research efforts that cannot be matched in a short time and therefore is sustainable long-term.

Basically, competitive advantage can be built on price (‘Be cheaper’) on one side of the scale or on value components generated by superior product fea- tures (‘Be better’), production and delivery times (‘Be faster’), or additional services (“Product and more’) on the other.



The Pitfalls of Low Price

As manufacturers in developing countries have traditionally been concentrating on a low price strategy, it is necessary to point out the dangerous pitfalls of this

approach to competitive advantage in a global market.

Firstly, the price is the one aspect of the offering with the greatest inherent instability. There is not one product or service feature that can be changed as quickly as the price. Within a second, the price advantage of one company can be eroded by a competitor’s on-the-spot decision to give an unusual rebate. While material, form, and quality of the product usually are clearly defined, sometimes even by official norms like ISO, the price always seems to be an issue open to discussion. Moreover, a price difference is what the customer feels first. That’s why it is always a touchy subject.

Secondly, today’s low price can be eroded quickly by new competition. Labor is cheap here in Sri Lanka’, says the optimistic low price entrepreneur. The intimidating truth is that labor is cheap here today tomorrow it will be expensive. Developing countries are very much in competition with each other. The most radical example is the garment industry, where Asian countries struggle for their shares in the global manufacturing volume. Considering that the weaving, cutting, and sewing equipment can be dismantled and set up within a few weeks, entrepreneurs will move on to countries with even greater resources of cheap labor as soon as labor prices rise too much in one country. Once the WTO quota for garments falls in the year 2002, competition in this sector will be even more ruthless, and a pure low price strategy will be difficult to maintain.

Thirdly, in global trading the price advantages fluetuate largely with the currency exchange rates. Due to their high economic growth rates and sometimes lax monetary policies developing countries regularly show signs of monetary instability. If one country’s currency suddenly devaluates as often observed in the past, the competitive advantage of a favorable price can fade within an instant, and the basis for success is endangered.

When relying on the traditional low price approach, companies should keep these risks in mind. A proactive search for alternatives to secure competitive advantage in the future seems necessary.

Competitive Advantage through Values

A viable alternative for Sri Lankan-based enterprises is the value approach to competitive advantage. Companies in the Free Trade Zones (FTZ) have already proven that global strategies which build on quality, time, and service can operate

successfully in the island:

Focus on Quality Paragliding is an ever more popular high-tech sport in Europe and America, requiring equipment based on advanced aerodynamic engineering and immaculate manufacturing. Top of the line quality in para-gliding equipment is being produced in Sri Lanka by an entrepreneur, who started out as an amateur. Against well-established producers in the USA, the Sri Lankan company has now reached a competitive advantage in this market, which will hardly be endangered in the future. The simple secret is that all the processes within the company focus on quality.

Exact measuring, cutting, sewing, and assembling of the sensitive materials used can only be implemented by a highly skilled and motivated workforce that mainly comes from traditional Sri Lankan backgrounds, where handicrafts are part of daily life. While the employees know the machinery and tools in and out and assure quality independently at each production step, the entrepreneur can concentrate on further improvements and global marketing of his fine goods.

With the involvement of the workforce, the company has developed a new emergency chute, which surpasses international standard and is recognized worldwide for the durability and comfort of its backpack-seating equipment for the paraglider.

Focus on Time

‘We have only one question: Can you deliver within 12 weeks?”, a struggling European manufacturer of high-performance punching tools for metal parts was asked by a potential Asian customer. This question was the spark to make delivery time the new focus of the company’s strive for competitive advantage in the global market.

A plant in one of Sri Lanka’s FTZ was quickly established, used computer-controlled machinery (CNC) as well as industrial design equipment (CAD) was shipped in, and training of Sri Lankan engineering graduates and talented technicians started immediately with the help of local training institutions like the National Apprentice and Industrial Training Authority (NAITA).

The unmatched time advantage of this company is made possible by a minutely planned division of tasks in the design and production processes between the

European and the Sri Lankan plant as well the proximity of the latter to the Asian market. The high qualification of management and workforce is the foundation for 100% time reliability, which has recently enabled the Sri Lankan plant to win first orders from a Singapore computer components manufacturer.

This reliability is worth more than 20% higher prices to the international clients, and constitutes the root for long-lasting customer relationships. Focusing on this competitive advantage, which cannot easily be undermined by a competitor, the Sri Lankan plant can head into a bright future..

Focus on Service

A former dealer and maintenance service for power generators now builds his competitive advantage upon the now widely demanded service of ‘Energy Management’.

The agonizing Sri Lankan energy situation of 1996 had made importing and dealing in power generators an easy and worthwhile business. Demand and prices were stable. Due to the heavy use of generator units the maintenance departments were making overtime. With the drastic improvement in the power situation today, the market has completely turned around and dealers are facing continuously decreasing demand with price negotiations pushing the margins to unbearably low levels.

The innovative dealer reacted by redefining his business, offering companies support in reducing their energy costs up to 50%. Electrical engineers of the maintenance staff devised a service concept along with a program on a laptop computer calculating potential energy savings directly during the consultancy of the customer. The next step in the service process is the selection, sales, and installation of energy-saving equipment, such as capacitors to increase the power factor, energy-saving light bulbs, or the good old generator unit- this time in use to compensate peak consumption. The final stage is the negotiation of a maintenance contract guaranteeing the customer first priority treatment for regular preventive maintenance and repair in case of critical failures.

Again, a far-sighted entrepreneur has escaped the pitfalls of price-sensitive traditional business practices by creating competitive advantage based upon valuable services delivering real benefit to the customer. Such a customer relationship is not vulnerable to aggressive competitive action.

Creating Added-Value

The main ingredient in the recipe for value creation is a thorough understanding of the customers' needs. The objective must be to identify potential values which are important and visible to the customer. Those are the values that he is willing to pay for and at the same time the ones to create competitive advantage.

Each company has its very specific opportunities to upgrade its products depending on the know-how and the financial resources. In the end, creative thinking is imperative. This summary of some typical approaches can only be a starting point:

The process of creating added-value should be well-structured. After generating a set of ideas, suggestions have to be screened, selected, and eventually decided upon. An implementation plan with responsibilities and timing must be devised and carefully integrated with the technical and production issues, customer requirement and market introduction.

Value Creation at the Different Process Stages

(Examples)

Raw Materials and Input Logistics	Product and Production	Packaging	Sales and Marketing
Higher Quality of Raw Materials	Improved design/ looks of product	More attractive packaging	Warranty
More flexible purchasing procedures	New features, new benefit	Keeping products fresher	Image (quality, exclusiveness etc)
Develop/ produce more raw materials or components yourself (Backward Integration)	Greater Durability	Easier to unpack	Establish and maintain Brand Name
Advantageous terms of payment	Forward Integration	Better protection of products	Faster /Broader distribution
Quality certification of components and suppliers	Higher precision	Re-use or Recycling of packaging	Pre-sales consulting
	Make products easier to install		Installation Services
	Optimize production process time		After sales service

Typically, companies request the expertise of external specialists, may it be a

research agency for market investigation, a technical expert for the product development, or a consultant to train the sales and service staff.

Whatever the added-value chosen for the future, it has to be backed by the distinguished competencies of the company in order to turn into a competitive advantage in the marketplace. Just as crucial is the cost-benefit relation, since in the end – the investment in more value has to pay off in profits. In this context, it is important to understand that added- value does not necessarily mean big investments in expensive new machinery and equipment. The first attempt should target at improving value with existing resources.

Conclusions

Sri Lankan companies just as much as foreign investors should not get trapped into the one-dimensional approach of viewing developing countries as low cost – low price – low quality suppliers. Low price strategies for manufacturers can only be the starting point for global competitiveness. In the future, competitive advantage in the global market will be based upon improved price-value relations through better quality, service, and delivery times. More farsighted local enterprises as well as foreign investors have already proven that Sri Lanka provides many of the prerequisites to master this challenge successfully.

Falk O. Petersdorf holds a Masters Degree in Economy and Business Administration and has several years of international experience in Management Consulting and Training. He is cur rently working as a Productivity and Quality consultant at the Sri Lanka German Private Sector Program (PSP), a project of the Ministry of Industrial Development, Sri Lanka and the GTZ German Development Corporation.