I’m often asked by clients in such industries as electricity, food, concrete mixers, reinforcing steel, and professional services, how to get a decent price for their products or services. Their products and services are rapidly becoming “commoditised”, they complain, and “everything comes down to price”.

It’s a good question and one that doesn’t have easy answers. Before I make some suggestions, let’s see if we can come to a precise definition of what makes a product or service a commodity.

What’s a Commodity?

We might start off by noting that a commodity exists where a product or service has become standardised. Primary products like iron ore, wheat, wool and coal are classic examples. But manufactured products such as electricity and products for which detailed specifications and designs are laid down can also move into the commodity class – concrete and reinforcing steel, for instance.

Services, too, can become commodities. An article in the Sydney Morning Herald dated November 22, 2002, announced a “Sombre Mood in Julia Ross”. Julia Ross Recruitment is a public company providing recruitment services to organisations. The accompanying picture showed three glum-faced directors at their annual general meeting, with the Chairman announcing that “this market is becoming increasingly competitive and commoditised, with resultant pressure on margins”. Julia Ross faced fierce competition for contracts from global recruitment firms such as Adecco, TMP and Manpower. The result was a profit downgrade, and their shares tumbled 25 per cent from a week earlier.

Commoditisation has also occurred in the legal profession with the conveyancing of property. Once thought to be tricky and complex, now conveyancing is carried out by specialists for a fixed fee and at “low cost”.

It appears few industries are free from this phenomenon of commoditisation.

Characteristics of Commoditised Industries

When a product of service drifts towards the commodity category, strategic factors such as product or service features become standardised. As a result, customer focus gravitates towards price, and the opportunities a business has to differentiate itself from its competitors appear to narrow.

A look at a few different industries will show us how strategic opportunities vary according to the extent to
which a product or service has become a commodity.

In the case of a manufacturer purchasing electricity from Energy Australia, the strategic factors in its relationship with the supplier include price, service quality (supply reliability) and customer service. Since there are no types of electricity, one of the strategic factors, product range, isn't relevant. As the manufacturer rarely needs service and takes the quality for granted, the focus goes onto price.

This is different from a consumer of canned fruit and vegetables produced by organisations such as SPC, Heinz and Golden Circle. Here the strategic factors relevant to consumer choice are more numerous and include price, image/brand, product quality, packaging, product range, availability and consumer service. Not only is the range of strategic factors wider than in the case of electricity (and other commoditites), but so is the variation in product quality between brands. And image/brand is very important to consumer choice. It plays a role in consumer choice. It plays a part in the decision by both your customers and non-customers to choose or not choose you over your competition. In the case of a provider of public seminars to managers, for example, these include location of seminar, image/reputation of company and presenter, learning outcomes, seminar duration, timing, customer service and price. Understand the importance of all of these, and you're on your way to developing effective strategy and moving the emphasis away from price alone. Otherwise, price will tend to dominate.

Avoid Tendering Situations.

One of our clients, who manufactures concrete mixers that go on the back of trucks, and whose customers and non-customers are Pioneer, CSR, Readymix and Boral, among others, complains that the person who decides on the successful tenderer in these organisations is a "bean counter". Such a person, our client says, isn't able to assess the differences in the labour-saving, maintenance-saving and efficiency features of his mixers. As a result, the decision can come down to nothing but the difference of a few dollars on price. The decision-maker may be shortchanging his or her organisation in the long term, but it never gets to know. If possible, don't go there!

Identify the Strategic Factors for Your Customers.

If you don't, you can't do anything effective in competitive strategy. Strategic factors are the decision criteria used by both your customers and non-customers to choose or not choose you over your competition. In the case of a provider of public seminars to managers, for example, these include location of seminar, image/reputation of company and presenter, learning outcomes, seminar duration, timing, customer service and price. Understand the importance of all of these, and you're on your way to developing effective strategy and moving the emphasis away from price alone. Otherwise, price will tend to dominate.

Sell Value, Not Price.

Think of products or services that are expensive in their categories: Rolls Royce in cars, TAG-Heuer in watches, Mont Blanc in pens and Sofitel in hotels, to take but a few examples. None of these compete on price – they couldn't, since a potential customer has the option of paying just $25,000 for a car, $15 for a watch and so on. What these companies do compete on is value. Price is balanced against other strategic factors such as product features, service range, image and customer service. To avoid the commodity-price trap, always bring the buyer back to value – in all promotional material, project proposals, etc. But to be able to do this, you have to look at value from the customer's point of view. And this is quite a challenge for many inward-looking, production-oriented businesses.

Sell to Senior Management.

When products or services become commodities, the decision on who gets the work is frequently delegated to lower organisational levels – as in our concrete mixer example above. The more junior person probably doesn't appreciate the true value of the product or service to the organisation. Senior management, by contrast, is in a far better position to look beyond mere price and to appreciate value – value based on price and performance. This means evaluating achievements on strategic factors such as product or service quality, product or service features and ongoing customer service.

If an Exporter, Consolidate Supply.

The Australian Wheat Board (AWB) operates as a "single desk". This means that Australian wheat is sold overseas through one seller only, and buyers are unable to pit one Australian wheat producer against another, thereby forcing Australian wheat prices down. There have been many attempts from overseas to break up the AWB, but so far they have been unsuccessful. The lesson for other commodity producers in products and services is, where possible, to consolidate your offering and avoid competition on price alone. But don't try this within the country – it might be labelled collusion.

Build Your Brand.

A brand communicates many things. First off is the image of your organisation, and here Mercedes Benz, IBM and Coca Cola come to mind. Your reputation – for good or bad service, for instance – also gets wrapped up in your
brand. Creating brand awareness among customers can generate brand loyalty, provided you deliver value consistently. The message, then, is to differentiate yourself from your other "commodity producers" so as to promote your brand and what it stands for: quality, professionalism, integrity, thoroughness, expertise. Remember Australian wool’s promotion around its brand and the image it wished to create with “pure new wool”?

- **Build Relationships.** A further way to take the emphasis off price is to place it on people – your organisational team and your customers. Such an emphasis involves developing a rapport between a member or members of your organisation and the decision-makers in your customer’s organisation. There are numerous ways to do this: Christmas parties, corporate gifts, etc. One that is prominent at sporting and other entertainment events is the corporate box. A range of companies, in fact, make it a point to entertain their clients in order to develop personal relationships with them, as distinct from the more formal business relationships.

Mention of "relationship" brings to mind another and less expensive form of rapport-building: relationship marketing. Via newsletters, articles and emails, a company keeps in touch with its client base. For example, it may decide to provide clients with free updates on an important topic.

All these methods are subtle ways of building customer confidence in your company. It’s a way of proclaiming: “There’s more to us than price; we’re not just commodity producers”.

- **Invest in Negotiation Skills.** A client that supplies equipment to the mining industry is heavily dependent on the contracts it’s able to negotiate with its customers, suppliers and contractors. Dollars saved with suppliers and contractors and made with customers go straight to the client’s bottom line. But this client of ours has recognised that the deals it strikes are negotiated by a wide range of its managers. Geographically dispersed, they are often left to their own devices and vary enormously in their negotiation capabilities. Senior management has acknowledged that these managers may have had their prices bargained down and may have fallen into the commodity-price trap. The decision? To improve managers’ negotiation skills. We would add: as part of this improvement, have managers understand the strategic factors for customers, suppliers and contractors.

- **Test the Profitability of Your Customers.** Before you fall into the commodity-price trap and are pushed around by your customers, assess how profitable they are to you. Most businesses know their own profitability as a whole; many know what it is for the various units within the business; some are even aware of which specific products make a profit. These are numbers that flow from the accounting system and a series of breakthroughs. But assessing the profitability of customers requires a form of aggregation, across product lines, and most businesses don’t have this knowledge. When you do the assessment, allocate all costs, including capital costs, such as office, store or factory space, and overhead costs, such as office staff’s time. You may be surprised to discover that the very customers which see you as a commodity producer, those who are your biggest pains in the neck, are actually making you lose money.

To cite an example: a client of ours, a manufacturer of trusses and frames for houses, might sell products mainly from its mill. An analysis of mill activities showed that they weren’t bringing in any profit, after full costs were taken into account. The manufacturer weighed up the implications of losing certain customers if the milling operation was closed. After due consideration, the decision was made to proceed with the closure and, as a consequence, jettison the unprofitable customers. Lose the losers.

- **Change the Industry Business Model.** A business model is the way an organisation generates revenue and makes a profit. In most industries there tends to be a standard way of doing this and, as a result, products or services can become commodities. In some cases, competition becomes so fierce that manufacturers are exiting concrete mixers in order to concentrate on these industry segments where money can be made.

**The Need to Re-focus**

Many managers who get caught up in the commodity-price trap become tunnelled in their thinking, sucked in by a mindset. This phenomenon can overtake a whole industry – remember the recruitment field and Julia Ross Recruitment. The result is that organisations can become purely price-driven.

The suggestions I’ve made here to avoid this trap should assist you to re-focus your business.

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