How to Beat a Lower-Priced Competitor

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It's every company's nightmare: a competitor enters your market with a similar product priced at a fraction of what you currently charge. You need a strategy for beating the low-ballers. So what's the best way to proceed? On the one hand, all you need to do is drop your prices below the competition, and buyers will beat a path to your door. On the other hand, this approach will land you in a price war, and there are no winners in a price war — only survivors. Even if you manage to run your competitor out of business, chances are you may not have much of a business left when the battle is over. Luckily, it *is* possible to beat a lower-priced competitor without crippling your profits. That's the good news. The bad news is that you'll need to make major operational changes, and you'll need to rethink how you communicate with customers. The changes required may not be for the faint of heart, but they're better than the alternatives. So gird your loins, corporate warriors; you're about to embark on one of the biggest strategy challenges you'll ever face.

Things you will need:

- Plan to increase your annual sales and general administration (SGA) expenses for the current year by approximately 25 to 50 percent.
- Six months at bare minimum: three to make operational changes and three to inform customers of the change.
- **A Viable Product:** The overall quality and functionality of your product or service must be in the same general ballpark as that of your competitors.
- **Competitive Cost Analysis:** You need to know exactly how your supply chain, manufacturing, and distribution costs stack up against the competition.
- **An Executive Task Force:** You are about to undertake a major reorientation, so you'll need a brain trust of energetic leaders to guide and implement the changes.
- **A Top Advertising Firm:** Communicating your new value strategy to customers will probably require more creativity than you're likely to find in your own marketing group.

step 1

Select a Value Strategy.

Goal: Lay the groundwork for repositioning your product.

When customers prefer the lower priced of two items, it's usually because they believe the cheaper item is a better value. To compete, you need to get the customer to value your product more than the competition's — regardless of the price. According to Michael Treacy, coauthor of the classic bestseller *The Discipline of Market Leaders,* there are four market strategies that accomplish this:

1. **Lower your prices.** Yes, this is an option. The challenge is to do it without destroying your own profit margins. (We'll explain how to do that in the next step.) The big danger here is that you'll end up with a price war, so you must ensure that you have what it takes to be the last firm standing. Example: Dell underpriced PCs during the 1990s in order to grow market share.
2. **Build a uniquely superior product.** Customers will pay more if they're convinced your product is demonstrably better than the competition. This superiority can be "rational" (like a feature or function nobody else has), "emotional" (like a reputation for being "cool"), or a combination of both. Example: Car buyers pay more for Volvos because they're seen as safer than other cars.
3. **Create a hassle-free experience.** Customers will pay extra if your product is easier to buy and use than the competitor's. Example: Many shoppers happily pay more for the convenience of bagged lettuce, even though it is significantly more expensive than head lettuce.
4. **Take ownership of the customer's results.** Customers will pay extra if, in addition to providing the product, you take responsibility for ensuring that it generates the results the customer seeks. Example: GE's Magnetic Resonance Imaging (MRI) machines come with consulting programs, operating training, and a patient-preparation program — a package that ensures that the machines will meet the hospital's performance expectations.

Big Idea

Where Do You Fit In?

Think of product value as a grid. The left axis defines what you sell: Does your firm offer stand-alone products, or do you specialize in offering an ongoing set of services? The top axis is about your core value proposition: Does your offering compete largely on the basis of how much it costs, or does it offer features that make it unique? The more sophisticated your product gets, the more you can charge for it relative to the competition. Similarly, the more value your services provide, the more you can charge for them.

	Costs	Benefits
Products: "What we sell"	Price	Uniquely better product
Service:"How we do business"	Hassle-free purchase experience	Owning customer results

Source: GEN3 Partners, 2007

step 2

Reposition, Readjust, and Reallocate

Goal: Make the internal changes necessary to support your strategy.

1. **Lowering your prices = Changing manufacturing and distribution.** To beat low-price competitors at their own game while also remaining profitable, you need to squeeze every last drop of inefficiency and cost from your manufacturing and distribution system. Example: If your competitor has outsourced its manufacturing to China, consider outsourcing your manufacturing to Vietnam, where costs are even lower.
2. **Building a uniquely better product = Changing design and engineering.** Determine through market research what features or design will prompt customers to see your product as being unequivocally superior to the competition. Then get engineering to build it. Example: If you're launching a line of "designer" handbags, find out what fabrics and leather provide a look and feel that potential buyers view as "upscale."
3. **Creating a hassle-free experience = Changing sales and marketing.** Figure out why it's difficult to buy and use your competitor's product, and then make it easy to buy and use yours. Example: Pioneer recently offered giant console TVs for sale at Home Depot, because many customers often already had a truck in the parking lot that they could use to haul the bulky item home.
4. **Taking ownership of the customer's results = Changing customer support.** Build a deep bench of experts who really understand your customers' businesses. Example: Under Lou Gerstner, IBM hired and retrained thousands of consultants, transforming the company from a mainframe computer vendor into a computing services vendor.

Checklist

Self-Assessment: Your Firm's Core Competence

Pretend to be an objective outside observer and rate the following aspects of your company's operations:

5=Best in the industry
4=Better than average
3=We're OK
2=We stink at this
1=Say what?

Controlling our supply chain.	[ ]
Setting up channel partnerships.	[ ]
Designing great products.	[ ]
Basic research and development.	[ ]
Creating marketing materials.	[ ]
Building customer relationships.	[ ]
Keeping existing customers happy.	[ ]

Getting customers to refer prospects.	[ ]

Total each pair. The highest numbered pair indicates your core competency. Match that with the strategy you should embrace, below.

- First pair is highest: embrace a “lower your price” strategy.
- Second pair is highest: embrace a “uniquely better product” strategy.
- Third pair is highest: embrace a “hassle-free experience” strategy.
- Fourth pair is highest: embrace an “ownership of results” strategy.

Warning: if no pair adds up to more than 6, your company may not be a viable competitor.

step 3

Promote the New You

Goal: Communicate your new value strategy to potential customers.

Once you’ve implemented all the operational changes required to reposition your product in the marketplace, it’s time to tell the world why your firm offers superior value. That means adopting a communications strategy that matches your market strategy, as follows:

1. **If you offer lower prices, mimic the competition's go-to-market strategy.** Ensure that whenever a customer sees a competitor's product, your product is right next to it — at a lower price. Example: Kinko's searches out local print/copy shops and locates a franchise across the street, offering prices that the local shop can't match and eventually driving them out of business.
2. **If you build a uniquely better product, target your advertising.** Reach customer groups that are most likely to believe your product is superior by selecting venues that the competition neglects. Example: Sony's VAIO PC business advertises in lifestyle magazines to reach female buyers, who are more likely to appreciate the VAIO's sleek design.
3. **If you create a hassle-free experience, generate positive word of mouth.** Make it easy for your customers to sell for you. Consider “tell a friend” coupons or offer referral fees. Example: “Network Marketing” products (like Amway) are typically priced higher than store-bought items, but they are sold by neighbors to neighbors (that’s the word of mouth) and drop-shipped to the buyers (that’s the hassle-free part).
4. **If you take ownership of the customer’s results, create a presence as an industry insider.** Get your sales consultants out to conferences, working groups, and industry-association meetings where they can work closely with decision-makers and develop consulting opportunities. Support your consultants with a wealth of case studies and reference materials. Example: The IT consulting firm Accenture promises to take responsibility for the successful implementation of the strategies it develops for clients.

Case Study

How Microsoft Fought Back Linux

Ryan Kubacki, a former Microsoft executive who is now president of Holden International, explains how Microsoft reacted when Linux, the open-source operating system, first came on the market:

“When I was Microsoft’s business marketing officer for the U.S. central region, [CEO Steve] Ballmer drafted me to work on the company’s Linux strategy. When Linux first became big news, there was a perception in the market that because it was free, it was therefore a better deal than Windows. Since this was a direct assault on Microsoft’s business model, we build a team of experienced market research and messaging people, including a guy who had been one of Bill Clinton’s advisors during the Lewinsky scandal.

“The team polled around 6,000 IT customers and discovered that Linux was favored over Windows for a variety of reasons, some of them emotional (like envy over Bill Gates’s wealth) and some rational (like an unpopular licensing scheme). Since there was little we could do about the emotional issues, the team decided to attack the Linux value proposition.

“We told IT buyers, before making a commitment one way or the other, to find out what it actually costs to run a Linux shop as compared to a Windows shop. We provided reams of data suggesting that Linux was more difficult to integrate, more difficult to manage, and more difficult to support — all of which ends up costing more money than would be saved by avoiding a license fee. By emphasizing value rather than price, we were able to blunt the Linux narrative and keep it from becoming an overwhelming threat to Microsoft’s enterprise strategy.”

step 4

Prepare a Plan B

Goal: Secure long-term competitive advantage with a secondary market strategy.

You’ve got a new pricing strategy and a new way to market it to customers. That’s great, but do you really have what it takes to pulverize the competition? After all, strategy doesn’t occur in a vacuum. Just as you are responding to your competitor’s pricing moves, they will do the same in response to you. If you’re only better than your competition in one dimension, you run the risk that your competition will focus on that dimension to leapfrog over you. If you’ve got the best product, the competition may figure out how to make a better one. If you make things easy for customers, your rival could make things even easier. To prevent this, it’s important to simultaneously execute a secondary market strategy that supports the first. Here’s how it’s done:

1. Go back to the self-assessment in Step 2. Notice which pair of corporate characteristics had the second highest total.
2. Figure out what you would do to execute a marketing strategy if that pair had been your highest total. (For example, if “taking ownership of results” ranked second, you’d need to beef up your sales and support teams.)
3. Decide to what extent you can execute that secondary strategy without screwing up your primary strategy.
   Example 1: You’ve got a killer product that people love. Is there a clever way to manufacture it for less, so that your retail price will remain lower than that of the competitor’s crappy imitation?
   Example 2: Your product is the same as everyone else’s, but you can sell it for lots less. Compared to your competitors, is there a way you can get it into customers’ hands more quickly and with less hassle?

The challenge in executing a secondary strategy is that the four basic market strategies are, to a certain extent, mutually exclusive. Better products typically cost more to make. An “ownership of results” strategy often entails throwing resources at each customers’ problems until they are fixed.

Nevertheless, having a secondary strategy in place — even if you can’t make it fully effective — is a great way to keep competitors at bay because it makes it far more difficult for your rivals to beat you at your own game.

For Example

The One-Two Punch in Real Life

Product	Primary Value Strategy	Secondary Value Strategy
Apple PCs	Uniquely better product	Lower price (Now competitively priced versus mid-range Windows PCs.)
Domino’s Pizza	Hassle-free experience	Lower price. (Mostly through frequent coupons and specials.)
Kia Automobiles	Low price	Hassle-free experience (Pioneered long-term service warrantees.)
Marriot Courtyard	Low price	Uniquely better product (Pioneered idea of Internet connections in every room.)