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РЕАКЦІЯ НА ПАСТКУ СТАНДАРТНОГО ТОВАРУ – ГРАТИ ЗА ПРАВИЛАМИ ЧИ ЗМІНИТИ ПРАВИЛА?

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Пропозиція стандартного товару є поширеним на ринку феноменом. Чим сильніша конкуренція на ринку, тим складніше диференціювати продукт/сервіс і, в результаті, посилюється цінова конкуренція, а ціна стає ключовим критерієм покупки товару. Розглянуто суть пастки стандартизованого товару та трьохетапний процес уникнення наслідків цього явища.

Ключові слова: товарна пастка, стандартний товар, цінова компетенція, конкурентна перевага.

REACTION TO THE COMMODITY TRAP – PLAYING BY THE RULES OR CHANGING THE RULES?

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Offer commoditization is increasingly common market phenomenon. The stronger competition in the market, the more difficult is to differentiate the product/service – as a result, price competition intensifies and price is the key buying criteria. The paper presents the essence of commodity trap and the three-stages process of escaping from the consequences of this phenomenon.

Key words: commodity trap, commoditization, price competition, competitive advantage

Problem formulation. Increasing market competition intensifies belief about inevitability of price competition. However clever managers should be aware of alternative to such an approach – recommendation is to fight for the customer using the value of the offer, not the price. The result of treating price as the only criterion for offer differentiation is to deprive the opportunity to improve profitability and gain loyal customers. Appropriate perception of the current market situation should assume that a highly competitive market environment requires creating and delivering value to customers, otherwise the price will be the sole criterion for product differentiation – it may result in price wars. According to European Commission, commodity trap is the price-based competition throughout markets for standard goods and services, which puts pressure on wages and profit margins alike. Clearly, the way out of this trap is to create distinctive high value added products – both goods and services. The emerging transformation of the production of goods and services is dramatically altering what is produced, where, how, and who captures the value. It creates opportunities and challenges [1, p.3].

Problem of commodity trap has also a macroeconomic dimension – it is highlighted by the European Commission in a recent report *Escape from the Commodity Trap Will the Production Transformation Sustain Productivity, Growth and Jobs?*: “The way out of the commodity trap for wealthy countries, as we said at the beginning, is to generate new and innovative approaches to value creation and production,

developing distinctive high value added products, services and goods, as well as creating distinctive defensible positions in the production and distribution of lower margin more commodity like products” [1, p.21]. There are more and more often opinions about the broad significance of the problem of commodity. As A. Holmes writes, commoditization is no longer just about machinery, computers and plant. Nor is it about the odd industry or two. It is beginning to be about people, human capital, skills and expertise and it is spreading into those industries that have previously held up their margins and kept out the competition. It happens because the success of any business depends on having staff with the right mix of skills, attitudes and behaviors [2, p.2, 6]. Despite the broad significance of the phenomenon, the authors focused on the marketing dimension of commodity trap – particularly focusing on the issue of pricing.

Analysis of current research and publications. A commoditized market is one characterized by price-competition with little or no differentiation by brand and where the range of buyer budgets is small [3, p. 603]. In other words, industry commoditization describes an increase in similarity between the offerings of competitors in an industry, an increase in customers' price sensitivity, a decrease in customers' cost of switching from one to another supplier in an industry, and an increase in the stability of the competitive structure [4, p. 189]. It is possible to identify some distinctive aspects of commoditization: price sensitivity, switching cost, industry stability, product homogeneity [4, p. 190]. Baker claims that if company's offerings are not differentiated, they are commodities and the lowest price gets the business. The challenge for many firms is that their core offerings are commodities — or close to it. It is not a problem, because there are customers that have basic needs. But for the rest of markets, company needs something more to differentiate itself from the competition. In addition to high-value products, much of this differentiation will come from services [5, p. 114]. Among researchers there is a consensus that constant price undercutting can damage brand equity and erode margins, what is more customers develop low expectations and become disengaged [6, p. 86]. According to scholars, the commoditization of products is a prevalent phenomenon. Companies acting in commoditized industries face tremendous challenges to earn proper margins and therefore have to explore new ways to create competitive advantages. Increasingly, this trend also affects service industries mainly driven by the further deregulation of various sectors. Many service industries (e.g., telecommunication) now face similar challenges as many of the services offered move towards commoditized ones [7, p.731]. For a service-specific classification of commoditization Rothkopf and Wald suggest the following five characteristics:

- established providers and brands lose market shares as new entrants repeatedly compete in price and gain market shares. As a consequence margins tumble and profits decline.
- wide availability of a service driven by high demand and the ease of market entry.
- cut-throat competition and a high price-elasticity.
- undifferentiated and interchangeable offers. Customers frequently focus on core service specifications and are not willing to pay for additional service attributes.
- reduced pricing power of service firms through increased transparency [7, p. 733].

Commoditized markets are in most cases large markets with a rather high transparency for buyers. Due to the price-based competition, most companies achieve rather low margins. It is difficult to brand a commodity product since it offers no real points for differentiation. Often brands in commoditized markets lack image, feeling or a distinctive character resulting in a low customer loyalty. As price is the main differentiation point, the power of customers increases while at the same time the pricing power of the firms decreases. The process of transforming a product into a commodity is linked to the concept of the product life cycle. Several scholars argue that almost every industry is becoming commoditized after a while as most products will turn from specialties into commodities after a certain period of time [7, p. 732]. Most firms are facing commoditization of their core products. Finding it harder to stay ahead of the competition, the smart ones have invested heavily in creating value-added options: services, consulting operations, and capabilities for outsourcing entire business processes. Those that succeed create a cadre of loyal customers, high competitive barriers, and confidence in their prices because they are creating superior value for their customers [5, p. 117]. Company should fight commoditization by becoming

knowledgeable about the businesses of their major customers, and by using that knowledge to bring value-added products and services to their markets [8, p. 2]. What is also very important, commoditization issue concerns not only relations business-customer but also business-to-business. As the researchers claim, in today's competitive business environment, customers in the business-to-business (B2B) arena have more information, access to more choices, are more sophisticated, and as a result have higher expectations than ever before. For the marketers of industrial products, the end result of this highly competitive environment has to put forth a greater effort to create some form of product differentiation to avoid their products being viewed as commodities [9, p. 345]. As Baker writes, the potential for competitive differentiation is limited only by your company's imagination. Many business leaders lament that since their industries are mature, commoditization is inevitable, despite all the empirical evidence surrounding them that this is simply not so [10, p. 236]. A similar view is Tony saying that everything can be differentiated. As soon as the customers believe that two products offer the same benefits, then commodity buying is a reality and price becomes the decider. Author bans commodity thinking and recommends focusing on differentiation – he shows extreme examples of products (water, concrete, plastic) that, contrary to appearances, can be effectively distinguished from the competition – so it is possible to avoid simple price competition [11, p.83].

Article objectives. The aim of this article is to present the phenomenon of commodity trap and the process of avoiding the risks associated with commoditization of market offer. It is very important for companies to understand the significance of this phenomenon, which is closely related to the increasing market competition. The authors tried to present the essence of the commodity trap both in the product market and services market.

Presentation of the main materials. In a commoditized industry price is the key buying criteria. Products on offer are very similar in terms of functionality or design with none or few differentiating features which limit the extent of value-based competition. Commoditization is a very real threat to every organization and it is comparatively straightforward to identify the early warning signs, which include:

- increasing competition,
- prevalence of me-too products and services,
- a belief that all suppliers are fundamentally the same,
- the decreasing desire on the customer's part to look at new options or features,
- an increasing preference for customers to select on the basis of price and little else,
- a reluctance for customers to pay for anything they consider unnecessary,
- increasing pressures on margins [2, p. 5].

The commoditization of products is a prevalent phenomenon. Companies acting in commoditized industries face tremendous challenges to earn proper margins and therefore have to explore new ways to create competitive advantages. Three global megatrends are pushing companies into the commodity trap. And what is very important, root causes of commodity traps lie in global megatrends that cannot be influenced by a single company. Table 1 presents global megatrends and selected symptoms of commoditization – three out of seven global megatrends contribute to the root causes of commoditization, their impact on the global economy triggers the commodity trap.

Commodity trap has three interlinked aspects – customers, competitors and technologies, products, know-how [12, p. 19]. Among the factors on consumer behavior should indicate such issues as:

- transparency of product/service features, pricing and cost,
- globally accessible supply markets,
- changed customer perception of value – away from differentiation,
- decreasing customer loyalty,
- price-based buying decision – purchasing decides on supplier.

Global megatrends and selected symptoms of commoditization

Global megatrends	Symptoms of commoditization
Changing demographics Globalization and future markets Scarcity of resources The challenge of climate change Dynamic technology and innovation Global knowledge society Sharing global responsibility	New market players Emerging competitors from developing countries Globally accessible supply market Technological diffusion (to developing countries) Technological maturity with limited progress New substitute products/services Mass customization through modular products Changing customer perceptions of value Newly established price transparency

Note: three highlighted trends are these three out of seven global megatrends which contribute to the root causes of commoditization

Source: [12, p. 18]

Second group of factors relates to rivals:

- established technical standards – officially or de facto,
- new competitors previously unable or unwilling to compete,
- new market players from lower-cost/developing countries,
- excess production capacity, i.e. supply greater than demand,
- substitute products, e.g. at the lower end of the (previous) market.

The last group of factor connected with technologies, products and know-how includes:

- technological maturity, i.e. low rate of further development,
- standardization of technologies, interfaces, components, etc.,
- modularization of products – emerging mass customization,
- transfer of experts to emerging market competitors,
- know-how/technology diffusion (e.g. to developing countries).

Commoditization can start at any of the three elements of the trap. Elements reinforce each other, e.g. technological progress leads to standardized, easy-to-manufacture products or components; new players, also from developing countries, enter the market; customers rarely differentiate products based on their features – price remains the only differentiator. This ultimately results in significant price and margin pressure and, thus, in a commodity trap. As it was already mentioned, the biggest problem is when the core offering becomes a commodity. In the case of service companies it has identified four levers to innovate its core offering: the convenience of the physical product that is the basis for the service provision; the area of additional service features; pricing structure that offers many opportunities to differentiate, even in a price-sensitive commodity market; barriers to switch (loyalty program) [7, p. 749]. Baker draws attention to the elements of the services commoditization cycle which include: competition increases – increased price erosion – services added to stem erosion – costs increase – customer expectations increase – competition increases – ... [5, p. 119].

There is no doubt that one of the most important questions is *How to react to commodity trap?* The authors of Report *Escaping the commodity trap – How to regain a competitive edge in commodity markets* suggest two possible responses to the commodity trap – “play by the rules” and “change the rules”. Selection of the first solution means competing within the commodity trap (i.e. through price), increasing size and realizing economies of scale, costs restructuring and cutting. There is no doubt that the second solution is recommended-despite the efforts that have to be incurred to achieve the objectives. Fig. 1 presents three positions which correspond with decision about two mentioned solutions – accepting or fighting the commodity trap.

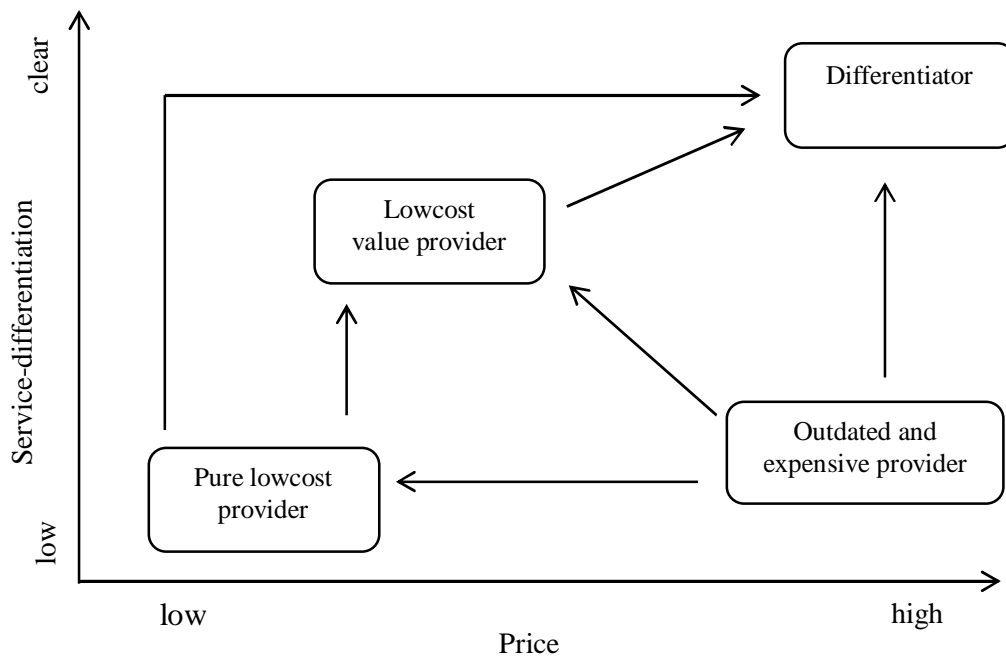


Fig. 1. Market positioning in a commoditized environment

Source: [7, p. 749]

As it is shown, companies can choose to be low cost providers of a commoditized service with little differentiation potential. In this case, it shall not innovate the core offering but has to have a superior cost structure – “play by the rules” option. The second position is a low cost value provider, i.e., a service company that provides superior value than pure low-cost firms at a comparable or marginally higher price focusing on some of the four levers. The third position is for firms that offer the commoditized core service with a perceivable difference that justifies a higher price – “change the rules” option. The choice of this approach requires the implementation of three stages (fig. 2).

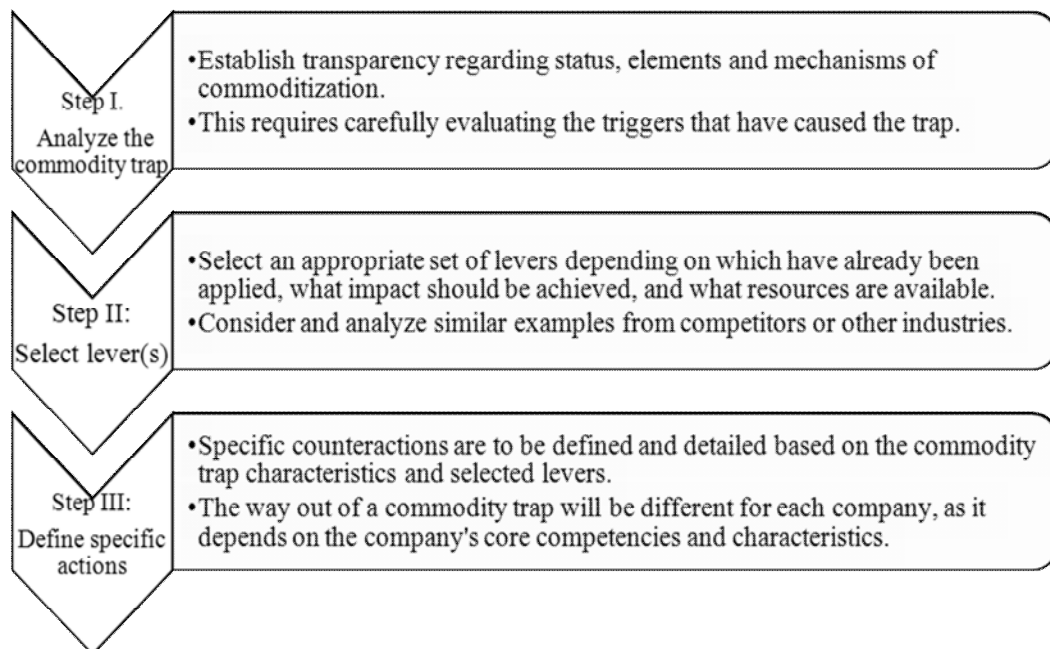


Fig. 2. The process of leaving the commodity trap

Source: Own study based on [1, p. 23]

The first stage involves an analysis of commodity trap including the three interlinked aspects (fig. 3).



Selected assessment criteria for analysis	Key questions to be answered	
1. Customer – Changing customer perceptions of value – Transparency on pricing and features – Rational, price-based decision making .	Which elements of the commodity trap are affected?	Transparency regarding indicators and mechanisms, and status of the commodity trap
2. Technology, products, know-how – Technological maturity – Customization through modular products – Standardization – Technological diffusion (e.g. to developing countries)  – Substitute products.	Which indicators can be measured or observed? Are all competitors affected by the commodity trap? 	
3. Competition – Globally accessible supply market – Excess capacity – Emerging competitors from developing countries – New market players – Established quality standards, e.g. legislative.	Have competitors already escaped the trap? If so, how? Which product and market segments are affected?	

Fig. 3. Step I – Commodity trap analysis

Source [1, p. 24]

Second stage is connected with selecting an appropriate levers from a set of three types of levers – short-term, medium-term and long-term levers (table 2).

Table 2

Step II – Overview of selected levers

	Levers	Examples
Short-term levers	1. Apply marketing and sales actions	Advertising, advanced pricing strategies, CRM, strategic product positioning.
	2. Upgrade/bundle products with services for differentiation	Extend warranties, ensure guaranteed availability, provide maintenance packages.
Medium-term levers	3. Shift toward specific market segments	Specific products for developing countries, high-end customers, etc.
	4. Use innovation to differentiate products	Focus on R&D activities to gain/maintain technology leadership.
	5. Improve product and delivery quality	Guarantee limited failure rates/downtime, on-time in-full (OTIF).
	6. Strengthen target cost/design-to-cost	Focus R&D activities on design-to-cost based on derived cost targets.
Long-term levers	7. Strategically align portfolio	Buy/sell business units.
	8. Strategically align the business model	Introduce new revenue model, switch to higher step in value chain.
	9. Create a suitable organizational basis to react flexibly to strategic challenges	Set up small independent business units with P&L responsibility.

Source [1, p. 24]

A set of levers has to be selected based on the desired impact and the available resources. It is worth noting that particular elements are characterized by different levels of impact and implementation effort (fig. 4).

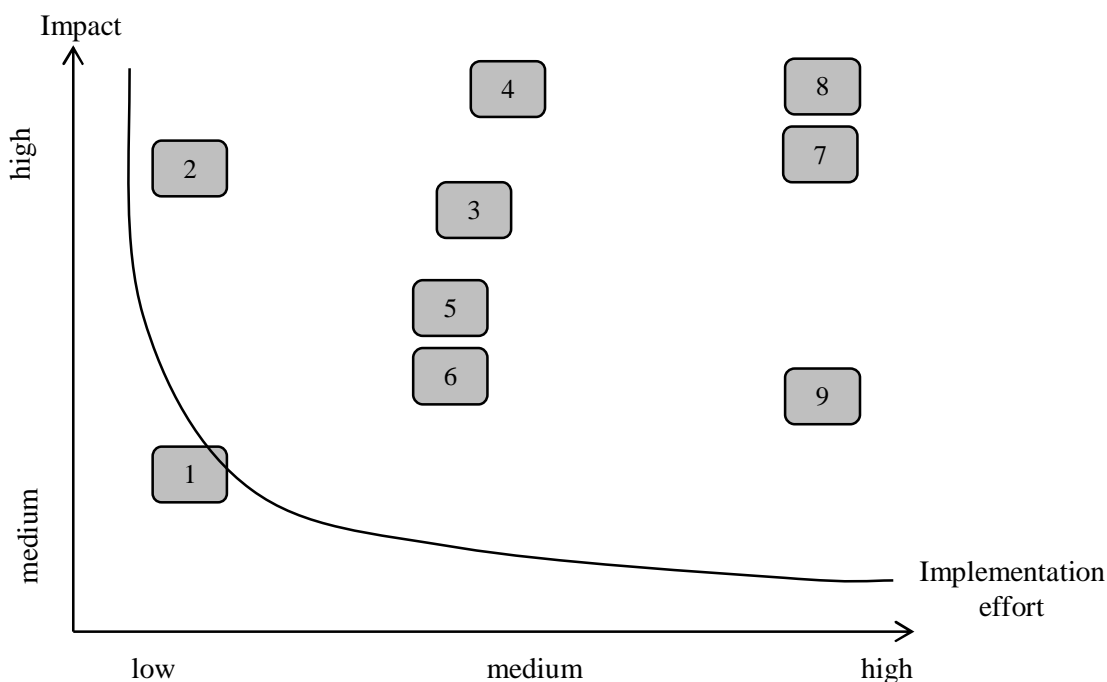


Fig. 4. Step II: Overview of selected levers and prioritization

Note: numbers from 1 to 9 correspond to numbers of levers from Table 2.

Source: [1, p. 26]

The specific actions for escaping the trap need to be developed based on the company's situation and prioritized set of levers. First of all company should define necessary actions – conduct cross-functional working sessions and derive a set of actions. Secondly, to develop action plans – prepare implementation plan and define results, milestones and responsibilities. Finally – to monitor implementation and action effectiveness and ensure sustainability. As a result of these actions company should escape the trap [1, p. 26]. It is worth mentioning that there are five key success factors for escaping a commodity trap:

- Core competencies – leverage core competencies to develop new know-how or business opportunities;
- Thinking outside the box – look beyond the current business model for ways out of the commodity trap;
- Change management – be aware that successful implementation, especially for business model innovations, requires comprehensive change management actions;
- Value chain and market segments – analyze all directions along the value chain and potential market segments in order to find the "white spot" for your future business;
- Sustainability – think of long-term, sustainable ways to escape a commodity trap – short-term actions usually only postpone the problem [1, p. 28].

Conclusions and perspectives for future research. The ability of the conscious price setting, called the price intelligence, is the key to survival in a highly competitive market. Price should not be the primary criterion for consumer choice – if so, it is a sign that company is in a commodity trap. This situation is unfavorable for the company but not hopeless. Phenomenon described in the article is universal – applies to both services and products, both market B2B and B2C. Knowledge of the components of commodity trap and trends intensifying the risk of it increases the chances for combating it. Undoubtedly the acceptance of pressure on price competition is not beneficial solution – the price war is just one of several unpleasant consequences for the company in such a situation. It seems that the only profitable solution is escaping the commodity trap through effective offer diversification-providing customers value-

added offers. Naturally combating the risk of commodity trap requires from the company strong commitment and determination, not every solution brings the same desired results. Usually better results are obtained with bigger effort, what is not so easy to achieve in a strongly competitive environment. The paper presents commoditization from offer point of view, but it would be very interesting to investigate this phenomenon taking into account customers' point of view directly. As it was shown in the article, one of the commodity trap indicator are clients, if so, the recommended way to escape from the commodity status is not what company does to its product but it should be what company does to its customers. Finding a way to reengage buyers is essential. Reason why commoditized customers choose on the basis of price is that they have become convinced that the options available are so similar that the minor differences among them are not worth investigating. Taking such a perspective – that not the offer is commoditized but the client is commoditized – study the phenomenon of commodity trap takes on a new dimension.

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