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Market Commoditization of Products and Services

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Abstract

Commoditization means a situation where a company's products and services are very similar to competitor products and services in features, prices, etc. Trend toward commoditization is still accelerating due to globalization, increased information exchange, technological developments and so on. Information transparency among competitors makes it difficult to maintain uniqueness. So, comes the price wars in order not to lose market share and hence top line figures. Commoditization needs an adjustment in present strategy. Differentiation is a very common approach for presenting higher value-add to customers, which should be an ever lasting process. Branding of products and services is a strong differentiator. Brand loyalty means any product/service is uniquely better and different, not cheaper. Following low cost strategies is a partial escape from commoditization. All those above issues have been closely examined in the context of theoretical framework.

Surviving in a Commoditized World

When the products/services provided by a firm can be supplied equally well by a number of other firms, then that product / service simply becomes a commodity (undifferented product/service) and price is often the only factor in supplier selection. Once a firm becomes simply a commodity with no value-add, the company often loses control of its destiny to other firms which add value and proactively manage the process on a value added bases.

If a customer cannot understand the difference and the value between similar competing products/services, in other words, if the product/service is indistinguishable than other offerings, then price becomes the only deciding factor and the companies employ strategies competing on the basis of low cost/low price. Priorities drive many companies toward commodity status; If one wants growth more than profitability, then commoditization may be indispensable; which means market is mature enough and attracts many competitors.

Traditionally the commodity was named for the following type of categories: (Coote, 2000)

a. Food products and fisheries (e.g. grains, tea, meat, fish);
b. Agricultural non-food products (e.g. cotton, rubber, tobacco);
c. Ferrous metals (iron, steel, etc.);
d. Non-ferrous metals (tin, gold, etc);
e. Industrial raw materials (e.g. non-metallic chemicals); and
f. Energy (e.g. coal, oil)

These markets are characterized by slow demand growth and over supply with a long-term real-price decline, coupled with stronger market power of commodity importers as a result of mergers, acquisitions, and substantial brand-advertising. Producers are price takers; they take what the market offers (Chafin and Hoepner, 2002).

The world-wide developments in the last two decades; namely the globalization, lowering of trade and investment barriers, rise of telecommunication and transportation technologies and other technological advances gave rise to the commoditization process for almost all kinds of products and services; and hence price wars increased and profit margins declined (Kim and Mauborgne, 2005, p.8). The concept becomes very popular in this era of rampant consumerism.

A commodity requires substantial volume which is generated by customer need, repeatability, strong lifecycle, price elasticity and adequate and continuous availability of product. A commodity must be convenient to buy, available through multichannels. How does one operate in a commodity market? A company must have the financial, structural and cultural resources.

Successfully managing a commodity business requires relevance, efficiency and control, in addition to branding, operations, products, merchandising, sourcing and logistic. For example, Wal-Mart can be seen as commodity experience because they have not differentiated themselves as offering consumer value other than the value of low prices.

Since commoditization is an externally instigated process - born of products maturation, market saturation, and industry dynamics - companies cannot stop the process. After the product has taken on a marketing profile, through volume and customer acceptance, these same success factors can lead to commoditization. Discount channels exist to bring products and services directly into a commodity position. The field immediately narrows to those that can deliver the commodity to the market at the lowest price. Buyers are interested to possess the products they buy with lowest cost available (Kotler, P. 2004). After certain point, quality and attributes become very similar to each other for different products/services. Then customers focus mainly on the price and hence producers' profit margin drops to the opportunity cost of capital (Doyle, P. 2003). According to a Copernicus research (Clancy, 2001), consumers cannot see differences between major brands in most product and service categories. As a result, more buy products based on price. Consumers perceive brands like Visa-MasterCard, L'oreal-Claisol, and Whirlpool-GE as increasingly similar to one another. Brand differentiation is declining over time.

However, companies can adjust existing strategies or find new ones that allow them to sidestep the march of their products/services toward commoditization. The first step is to recognize that different types of commoditization exist and to identify the type at work in the markets. In order to manage the process of commoditization, a new strategy has to be adapted that fits the present condition.

Companies may be able to postpone commoditization by capitalizing on existing markets, targeting underserved markets, developing new markets and niches, or finding new points of differentiation through branding, alliances, or other means. With efficient implementation of such strategies, companies that see their products heading toward commoditization can search about opportunities that lessen the pain and give them new life in their markets. According to a McKinsey survey (Forsyth and others, 2000); 70 percent of the purchasing decision was based not on price but on quality and service. "Cirque du Soleil" is an extraordinary model in this respect of de-commoditization through differentiation by an innovative idea (Kim et al, 2005).

The driver towards commoditization is perhaps the most powerful force in business today. Many items in our daily life can be viewed in commodity status like televisions, stereos, DVD players, portables, cameras, white durables and computers. PC's have reached a stage where they are extremely powerful. Standard PC's have become good enough to run almost any application. The core of the PC industry has already evolved innovation to standardization. Now, it is evolving from standardization to commoditization. This is dramatically changing the rules of the game. Many companies like Sony are consistently positioning themselves for the new market order (Otting, 2004). Many companies in B2C market are "de-commoditizing" them finding and capturing the value of intangible benefits and building strong brands that can provide a kind of differentiation in the minds of consumers. Final battle ground of marketing is consumers' mind (Trout and Rivkin, 1999, p.12). Average consumer does not need more performance (over-shooting) than he can buy already relatively cheap.

Price Wars

An obvious result of commoditization is competing on price basis. Price wars are the most common and visible reason for the fall of prices. Price becomes the main basis of comparison in the cases of a state of intense competitive rivalry, excess number of players in the market (where supply exceeds demand), excess plan capacity underutilized, competitive attack to gain higher market share and lack of unique product features. And hence a price war start which is good for the consumer but not good for the companies involved due to reduced profit margins that can threaten survival in the longer periods.

Price wars are very common phenomenon in almost all industry and sectors. There is no win-win outcome for any of the players. One exceptional situation might be in the long-run for a few dominant firms in the sector with lowest cost where all the marginal firms are eliminated. Those remaining dominant firms' prices might even be higher than the level before price war starts.

Trying to understand competitive landscape should be the first step in order to win a price war. Analyzing the customers, competitors and your own company, with special emphasis on cost structures and strategic positioning should be the starting point. Customer analyses can reveal what, besides prices, motivates your customers to buy your products/services. Competitor analyses help to estimate their pricing limitations and objectives. For example, if the competitor's objective is a short-run promotional activity, then the best response is to ignore the challenge. Differentiating by factors other than price can reduce the effectiveness of price competition. Introducing new features or emphasizing non-price features to customers can reduce their price sensitivity.

Although non-price responses are always preferable; there might be cases where price response needed to be used. In such cases, using complex price actions might give positive results. These include offering bundled prices, quantity discounts, price promotions, loyalty programs for products and two-part pricing (Rao and others, 2000).

If the price-competitive products are perceived to be of lower quality than your own brand, you can consider launching a new, low-priced brand that can compete directly with your low-price competitors. This allows you to compete effectively with price sensitive customers without damaging the brand of existing product lines. And finally, you can make your strategic intentions and competitive advantages obvious to your competitors by various signals, which is a strong argument to stop a price war before it starts.

Differentiation

Differentiation is one solution to avoid a product/brand of being a commodity. A differentiation strategy is one in which a product offering is different from that of one or more competitors in a way that is valued by the customers. The value added should affect customer choice and ultimate satisfaction (Aaker, 2001). Who it is that will pay for the differentiation, and the size of the market for the product must be considered. If differentiation is seen as the key, the differentiated attributes must be compelling enough to make customers feel to buy it. This means a series of characteristics and benefits that come together to make the branding strategy and product positioning a success. While price must be realistic, the product must be perceived to be different from the mainstream. According to Ries and Trout (2006, p.27), marketing is not a war between products but perceptions. Qualities such as prestige, image or any other "plus-one feature" are intangibles and present the opportunity for added profit.

A meaningful differentiation of products can be based on (Kotler, 2000, p.140):

- **a.** Physical differences (design, packaging, etc.),
- **b.** Differences in convenience for attaining,
- **c.** Service differences,
- **d.** Price differences, and
- **e.** Image differences.

A commodity is a product expecting to be differentiated. Below are successful examples of differentiated commodities (Kotler, 2000 p: 138):

<u>Perdue chicken</u>: A dead chicken has been branded and sold more expensive than other competitors.

<u>Colombian coffee</u>: People's mind usually perceives the Colombian coffee differentiated from the others.

<u>Marlboro</u>: A strong image made Marlboro the most differentiated brand among world-wide smokers.

<u>Absolute Vodka</u>: A very well prepared advertising differentiated Absolute from other vodkas.

Companies can sustain competitive advantage through product differentiation based on unique features and benefits which are valued by customers. In today's business environment, where the value added to products and services may quickly be commoditized, it is essential for companies to be focused on customers expectations to be aware of the product features that customers want.

How we know what customers want? Every time your customer touches your company they leave behind their words. Sources of words may include customer phone calls, mail, fax, website contacts, comments in survey, focus groups, etc. These unstructured data can be very useful if analyzed effectively. Every time a customer interacts with your company, they leave behind a trail of behavioral data. This data can become the basis for effective differentiation. By understanding their needs, it is possible to tailor your offerings in a way that 1) separates you from the competition, and 2) makes your offering a "fit" with the needs of your particular customer.

Every company is struggling to differentiate itself from competitors. However, eroding brand loyalty, increased cost of innovation and shortening the life cycle of products drive almost every consumer good to become a commodity. Especially due to rapid product life cycles, it is necessary to focus less on communicating features and more on benefits and solutions.

Designing a new product to match the competition feature-by-feature or adding a handful of features that do not really matter is not successful differentiation with almost no result. The black-hole of commoditization, which is extremely hard to escape, can be avoided by tailoring your value proposition to the market you want to own after intelligent segmentation. Today there is no market with single type of customer, but there are tens of small markets that you have to target. Different markets demand different value propositions. A good value proposition will compel a certain group of customers to do business with your company and not your competition. A remarkable example is the Four Horseman of commoditization: Intel, HP, Microsoft, and Dell. They have survived, and even thrived by articulating a value proposition that speaks to the markets they want to own (Kadanoff, 2004).

A clear and concise customer value proposition should be credible and compelling for the targeted segment showing how to differentiate your product from the offerings of competitors. Value means lasting motivation or aims that people search in their lifes. Marketing prepares and provides these means. In other word; values determine market demand (Tek, 2006, p.66). Cost, functionalities, advocacy, convenience, service, etc, are sources of value. Creating a strong differential will show your products/services better than alternatives which will exploit your company's care capabilities in the eyes of customer. Offerings must enhance elements of customer's value chain which competitors cannot easily match: development of technical support, special distribution and delivery, specific application to end use and so on. Once applied, that differentiated source of value is difficult for competitors to duplicate. Companies should strive for new features, outstanding designs, tailored service and close relationship with the customer (Kotler, 2004, p.75).

There are many ways to differentiate by adding value. Something can be done much better than it is done by competitors or an extra product, feature or service can be included. Value can be added to any aspect of a business. Aaker (2001, p.154) gives following examples to add value:

- Ingredient or component	- Service back-up
- Product offering	- Channel
- Combining products	- Design
- Added service	- Breadth of product line

Differentiation should be an ever lasting process. As the consumer become more sophisticated, complicated and better informed; products tend to be more commoditized. Consequently, in any sector, there are natural forces and tendencies that decrease the effects of differentiation (Porter, 2000, p.211).

Does Branding Helps?

Branding is a way to escape the commodity trap of competing on price and volume, which also helps the branded product survive in an environment where there is constant downward pressure on price. Branded products can increase market share, command price premiums, and deliver value to customer that exceeds what can be delivered by product features alone. Brands help create emotional and psychological ties with customers such that they become price inelastic. Positioning the product/service, using the right integrated marketing channels and creating a value in the minds of customers are the essential elements of branding.

How an offer can be differentiated to avoid commodity type competition? Generally the brand message itself is not differentiated: standard TSE listings, ISO certificate or similar typically maintain a brand message which almost every company applies; and hence brand indifferentiation becomes a fact.

On the other hand, building strong brands by creating brand equity is another route to differentiation. Even if you out-spec HP, for example, you may not win the day because its brand stands for a host of intangibles, including trust, reliability, good people, and also innovation in products (Aaker, 2001 p.164). Creating brand equity involves creating perceived quality and brand awareness, brand associator and brand loyalty. Brand equity generates value to the customer that can emerge either as a price premium or as a enhanced brand loyalty. Brands add customer value in the following ways; they can (Aaker, 2001 p.165):

- **a.** Help, interpret and process information,
- **b.** Provide confidence in the purchase decision, and
- **c.** Add meaning and feelings to the product.

On the other hand, as every expert agrees, we are now dangerously over retailed -too much is for sale, through too many outlets. Retailers are not opening stores to serve new markets anymore. They are opening stores to try to steal someone else's customers. Today; many tens of TV channels and FM radios, a World Wide Web of infinitely expanding sites that can be visited for information and a shrinking base of daily newspaper readers, all of which means that it is harder than ever to reach consumers and convince them to buy anything at all. Simultaneously, we are witnessing the erosion of the influence of brand names. That means that while branding and traditional advertising build brand awareness and purchase predisposition, those factors do not always translate into sales. Many purchasing decisions are made or can be heavily influenced, on the floor of the store itself. That building, that place has become a great big three-dimensional advertisement itself (Underhill, 2000, p.31-32).

Although commoditization is everywhere at once, one thing does not suit with the fact that many large companies from Compaq, Dell to Intel and Gillette in USA and from Vestel, Arçelik to Ülker and Turkcell in Turkey; have been able to maintain high profit margins and market share in business that should be susceptible to competition. In many industries, brand identification makes meaningful challenges difficult to imagine. The brand name becomes a kind of substitute for quality and reliability. For example, Intel's successful "Intel Inside" adds campaign has created a brand name for a product that observes once believed was the very definition of a commodity (Surowiecki, 1998). Branding successfully, in other words, can turn a small difference between products into a huge difference in market share and developing value-added brands put a company apart from the competitors in customers' mind. For example, branding commodity products through loyalty programs: Rewarding customers is a very effective brand-building tool.

Low Cost Strategies

These developments of commoditization made companies to set up or outsource manufacturing, research and development, service delivery or other business activities wherever the cost are lowest and capabilities and resources aligned with their business strategies.

There are many methods of obtaining a low-cost advantage with multiple approaches (Aaker, 2001 p.172-179):

a. No-Frills Product/Service,
b. Product Design,

- **c.** Operations,
- **d.** Economies if scale, and
- **e.** Experience curve.

According to Porter (2000, p.44); as a result of economies of scale and development of experience curve, companies can follow a cost leadership strategy. Efficiency and cost controls in AR&GE, services, sales force, advertising, etc, have to be strictly applied. Being a low-cost company brings revenue over-the-average of the sector.

Concept of Service Company

How to respond effectively to the inevitable maturation and commoditization of markets in the face of increasing competition? One of the most effective solutions of commoditization in the market place is converting the company from product into service company; that is, being a service provider.

- **a.** Durr Co. (a leader producer of auto painting systems) has majority of its experts working in customers' locations to assist them in quality and cost target achievement.
- **b.** Castrol (a leader in industrial oil production) has shifted its activity to seminars for achieving target performance of its customers.
- **c.** Boing has established a department in its organization for all kinds of service to airline companies.
- **d.** Ford has extended all service points in order to follow-up solutions.
- **e.** General Electric obtains majority of its profits from service providing rather than product selling.

Companies can position themselves as "consultants" in order to increase their customers' profits (Doyle, 2003, p.172-2).

Consumers of commodity service can be converted into consumer of high value-added services. A differentiating factor is not what you do, but the way you do it. This emotional connection keeps the customers with you. Service depending on the business and the commodity can be achieved at customer "touch points". The interactions must be valued by the customer and not seen as intrusive. After-sales service, particularly in the automobile industry, is one such critical touch point.

Conclusion

We are living in an era of strong commoditization effects. Mass customization is replacing mass production. Producers that tailor solutions to the needs of customers, not only enhance the value proposition of the product, but also make themselves a trusted source for meeting those consumers' future needs. As producers create new forms of differentiation, they also erect barriers to enter for low-cost providers. What commodity players especially in the B2B market are having success? Segmenting and targeting the markets, understanding their problems and executing to deliver solutions through products and/or various types of services.

De-commoditization is possible almost in every field for a very large part of commodity or near-commodity goods and services, especially by formulating value propositions that satisfy consumer desire for benefits like performance excellence and communicating value through effective positioning.

Companies should transfer their approach from "product supplier" to "advisor to the customers' problems". One should embrace commoditization since it is inevitable. Many companies take commodity management as a core competency. Finally, effective marketing can provide commodity business with high returns; but ineffective marketing is worse than no marketing at all (Narver et al, 1990).

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