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How to compete effectively against low-cost competitors

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Abstract Unlike older models of low-cost competition that were based on economies of scale, many new low-cost competitors have been able to be efficient at smaller sales levels due to a combination of the following strategies: producing 'good enough' products that provide extreme value by eliminating services that cost more than they are worth to consumers, utilizing simple business models, reducing research and development expenditures via joint ventures or through purchasing technology from bankrupt firms, using price cutting to drastically expand the market for a company's goods and services, and having an organizational culture that stresses frugality and efficiency. This article explores the low-cost strategies of Aldi, Vizio, and Southwest Airlines to identify common elements. Four strategies that established competitors can use to respond to low-cost competition are presented: (1) waiting and watching, (2) deciding not to match new competitors' price levels, (3) matching or coming close to low-cost competitors' price levels, and (4) developing a new fighter brand or private label brand to be sold along with a company's traditional brands.
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1. Introduction

The traditional model of low-cost competition based on economies of scale gave established firms the advantage of lower production and material costs due to their high market share. In contrast, many low-cost competitors are now smaller firms that have lowered their cost structure due to a combination of the following strategies. Some new competitors produce merely 'good enough' products that provide extreme value by eliminating services that cost more than they are worth to consumers. Others use simple business models. In certain industries, new firms have reduced research and development expenditures via joint ventures or through purchasing technology from bankrupt firms. Price cutting is another means to drastically expand the market for a company's goods and services. Lastly, many low-cost competitors maintain an organizational culture that stresses frugality and efficiency. Low-cost entrants that have successfully challenged traditional competitors can be found in such industries as premium California wines, flavors and fragrances, IT services, open-source software, pharmaceuticals, intercity bus transportation, electronics, airlines, and retailing (Ryans, 2010b).

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Three factors can be used to explain how low-cost firms have entered traditional markets: deregulation, globalization and outsourcing, and technological innovation. Deregulation has opened up markets to new competitors in such markets as air travel, telecommunications, and financial services. Globalization of production has reduced labor, material, and environmental compliance costs. Lastly, technological innovation as a result of research and development has provided new low-cost competitors with significant cost advantages over existing firms. Let's further examine the impact of these factors.

Deregulation of air transportation markets in the United States (1978) and Europe (1997) has spurred new competition from such low-cost competitors as Southwest and ValuJet in the United States and Ryanair in Europe. Many of these discounters have been able to reduce their initial capital requirements by purchasing and/or leasing older aircraft. In addition, because the personnel are non-unionized, these low-cost airline startups have been able to pay pilots and crew members below market salaries. Furthermore, these new competitors typically have reduced their operating expenses by flying into smaller airports with low landing and take-off fees.

To become more competitive, firms in other industries have copied the strategies of successful new competitors in deregulated industries such as the airline industry, the telecommunications industry (deregulated in 1996), and financial services (deregulated in 1999) by:

- selectively reducing service levels to cut costs on services that consumers are willing to forgo in exchange for low prices;
- restructuring traditional business models in innovative ways to drastically reduce operating costs as well as capital requirements;
- competing on the fringe of established competitors' markets to avoid direct retaliation; and
- using price cuts to drastically expand the market for a good or service.

As a result of globalization and outsourcing, many low-cost competitors have started in rapidly developing economies such as Brazil, Russia, India, and China. Low-cost imports have high market shares in a number of industries including cement, textile equipment, home appliances, furniture, and communication equipment (Bernard & Koerte, 2007; Ryans, 2010a). Many traditional U.S.-based firms have found it difficult to compete against these low-cost competitors due to their relatively high labor costs as well as the high cost of meeting regulations relating to worker safety, emissions, and other legislative requirements.

Technological innovation is a third element that has enabled global competitors to deliver variety at a low cost. According to researchers, Chinese competitors have been particularly skillful in leveraging their lower labor costs by applying world-class research and development resources to ordinary products (Zeng & Williamson, 2007). To reduce the costs of entering the communications market, Huawei, a leading global information and communications technology [ICT] provider, tried to buy 3Leaf Systems, a bankrupt networking hardware startup, for $2 million in 2010. This acquisition would have enabled Huawei to acquire 3Leaf's technology at a low cost instead of developing the technology on its own (Cody, 2012). However, the U.S. government's Committee on Foreign Investment (CFIUS) blocked the purchase. To avoid potential problems with future U.S. acquisitions being approved by the U.S. government, Huawei is now seeking to acquire firms in Canada, Israel, and China that own valuable cloud and information communication technology (Cody, 2012). Similarly, Haier, which is now the world's best-selling home appliance brand, was able to avoid costly research and development investments through licensing technology from Liebberr, a German manufacturer of premium-quality refrigerators, and through joint ventures with Mitsubishi and Merloni, an Italian appliance manufacturer (Khanna, Palepu, & Andrews, 2012).

This article seeks to appeal to new and existing low-cost competitors as well as incumbent firms. Low-cost competitors will benefit by becoming aware of additional sources of low-cost production and marketing and by being better able to anticipate the timing and range of incumbent marketers' competitive responses. Incumbent marketers will understand that their previous strategies based on economies of scale may be vulnerable as new competitors can be on a different cost curve. Incumbents will also gain insight as to which products and markets are most vulnerable to low-cost competitors, as well as how to select and implement the most appropriate competitive response.

2. Understanding which firms and products are particularly vulnerable to low-cost competitors

Mature industries and products offered by mid-quality-range firms are particularly vulnerable to low-cost competitors. Many mature industries are characterized by low research and development

expenditures, old-school firms that resist change, and a belief among existing firms that their industry's low growth rate deters new competitors from entering the market.

Mid-range products are also vulnerable to low-cost competitors since traditional firms often allocate too high a proportion of their research and development expenses to their top-of-the-line goods (Kachaner, Lindgardt, & Michael, 2011). Many mid-range goods were neither exceptional enough to justify premium prices nor cheap enough to win over value-conscious consumers (Ryans, 2010a). Michael Porter (1980) refers to vulnerable firms as being "stuck in the middle" as they do not offer a low price, a differentiated product, or a good that appeals to a market with specialized needs.

3. Aldi, Vizio, and Southwest Airlines as low-cost models

This section examines the overall low-cost strategies of three very successful low-cost firms: Aldi, Vizio, and Southwest Airlines. Aldi is an extreme value grocery chain with operations in Europe as well as the United States. Vizio is the largest producer of HD TVs in the United States. Southwest Airlines is among the most consistently profitable U.S. airlines (CAPA Centre for Aviation, 2014). Other successful low-cost competitors include India's Aravind Eye Hospitals, Britain's Direct Line Insurance, China's Hauwei telecommunications equipment, Sweden's IKEA, Ireland's Ryanair airlines, Israel's Teva Pharmaceuticals, and the United States' Vanguard asset management services.

The strategies of Aldi, Vizio, and Southwest Airlines need to be carefully studied. Incumbent firms, as well as new low-cost competitors, should determine which aspects of Aldi's, Vizio's, and Southwest Airlines' strategies can be incorporated into their overall business plan: reduce amenities that add little value to customers, use interchangeable versus custom parts, and/or utilize assets better through outsourcing and reducing inventory levels. Alternatively, incumbent and new low-cost competitors could develop competitive strategies based on specific vulnerabilities of these and other low-cost firms such as the lack of a full product line, few points of sale, limited hours of operation, inconvenient locations, and limited choice.

3.1. Aldi

Aldi, a German discount food store chain with over 1,200 stores in 31 states, uses a low-cost strategy in the United States very similar to the one successfully used in Europe (Berman, 2011). Much of Aldi's cost advantage is from its low rental costs, minimal fixtures, standardized pricing across all stores, and lower inventory holding costs. Aldi's average store stocks 1,400 or so items versus 40,000 at a traditional supermarket. To save on labor costs—a significant expense for food-based retailers—Aldi's store hours are limited to the most popular hours of operation. Lastly, Aldi does not accept credit cards or checks, which often charge merchant fees.

The combined effects of Aldi's 'pile it high' and 'sell it cheap' strategies gives it the distinction of "operating the leanest low-cost model" in food marketing in the world (Ritson, 2008). Aldi's total costs for logistics, rent, overhead, marketing, and labor account for 13%—14% of an item's cost (Steenkamp & Kumar, 2009). In contrast, total costs for these items in traditional supermarkets, including Aldi's four largest competitors in the U.K., account for 28%—30% of a product's cost (Kumar & Steenkamp, 2007).

Aldi's overall cost-cutting strategy has been so effective that it is credited as a major factor in Wal-Mart's pulling out of Germany. According to a retail consultant, "Aldi literally ran Wal-Mart out of continental Europe, and now they're taking the fight to Wal-Mart in the United States" (Bustillo & Martin, 2010, p. B1). Despite its low prices, Aldi is aware of the dangers of sacrificing quality to achieve low costs. According to the head of Aldi-Australia, "We are hard discounters who start with brand quality first. And that is absolutely where we start" (Webb, 2008). Aldi's private label gin, for example, recently received a silver medal award at the International Spirits Challenge blind tasting. Its gin was ranked at the same level as competing gin products costing as much as five times its price (Smithers, 2013).

Aldi wants to be simple, cheap, but good. A study of Aldi's culture notes the importance of extreme frugality at Aldi (van Luit, 2006). Frugality is stressed through such examples as the need to search for more efficient lighting, the use of wind deflectors on trucks to reduce fuel usage, and the quest for more efficient packaging from suppliers.

While Aldi and Trader Joe's are owned by the same firm, they have very different strategies. Trader Joe's sells more upscale foods, uses more costly locations, accepts credit cards, has higher levels of sales assistance, and uses sampling stations in most stores. Both Aldi and Trader Joe's have a high concentration of sales in private label goods and stock less than 3,000 SKUs versus 46,000 for an average supermarket.

3.2. Vizio

Vizio, a privately held manufacturer of consumer electronics, initially sold its televisions through Costco at retail prices of $3,000—one-third the price of comparable Sony and Panasonic models (Edwards, 2010). Vizio still maintains a significant price advantage relative to its major brand competitors. An IHS analyst stated: "I would expect [Vizio] to have an average selling price at least $100 lower than Samsung [the number two market share leader]" (Tarr, 2012, p. 28).

Vizio's overall low-cost strategy is based on four components: the availability of high-quality interchangeable parts, minimizing inventory levels, using contract manufacturers, and selling through warehouse clubs (Engardio, 2007). Let's examine each of these.

While Vizio's major competitors, including Sony and Panasonic, build major electronic components in-house, this strategy requires investments in the billions of dollars. In contrast, Vizio buys LCD and plasma display panels as well as other key components from major electronics manufacturers and independent manufacturers. Vizio is careful to maintain good relationships with key component makers in Japan, Taiwan, China, and Korea to ensure that it can continually obtain high-quality components. As evidence of its high quality and value, a recent issue of *Consumer Reports* found that three out of seven Vizio television models tested were ranked as best buys ("Best TVs," 2013).

Vizio uses Foxconn and AmTRAN Technology, two huge Taiwan-based contract manufacturers, to assemble its products: both have equity stakes in Vizio. With prices dropping 3%—5% a month, Vizio carefully plans its inventory needs so it does not over-order. In addition, the company keeps only 2 weeks of inventory on hand by negotiating flexible terms with its key suppliers. The constant monitoring of inventory gives Vizio the ability to increase or decrease production based on demand and to minimize the assets tied up in inventory without having stockouts.

Unlike traditional competitors that sell their products in big box stores like Best Buy, Vizio sells most of its products through warehouse club stores like Costco and Sam's Club. These retailers have lower margin requirements than box stores. The use of warehouse club stores also enables Vizio to produce fewer models in each size (as membership clubs traditionally have much fewer SKUs than traditional big box stores), to have less direct competition with other branded goods, and to reduce in-store promotional support-related expenses. Lastly, firms like Costco provide 90 days no-questions-asked return privileges, as well as a free 2-year extended warranty on all electronics, including Vizio televisions; this generous return and extended warranty policy reduces a consumer's risk in purchasing a Vizio television.

Vizio's culture is based on creating products that are on the leading edge of technology but are also affordable—and efficiently produced. Vizio fully recognizes that the efficiency of its research, production, and marketing efforts play a major role in the company's ability to outprice its competitors (Cassano, 2012).

Vizio's low-cost strategy has been so successful that its market share of the LCD television market in the United States grew from virtually zero in the first quarter of 2005 to 9.1% in the first quarter of 2007 and to 18.5% in the first quarter of 2012 (Miller, 2007; Tarr, 2012). Based on research from IHS.iSuppli, Vizio was the best-selling U.S. LCD television during the first quarter of 2012 (Tarr, 2012).

3.3. Southwest Airlines

Southwest Airlines owes much of its cost effectiveness to its operational excellence, including the use of one aircraft model for its entire fleet, the fast turnaround time of its planes, and the use of a point-to-point distribution system.

By using one model, the 137-passenger Boeing 737, for its 500+ aircraft, Southwest has low training and labor costs for its flight attendants, pilots, and mechanics; it can standardize ground services at all of its airport locations to reduce spare parts inventory; and it is better able to replace a delayed plane due to weather or mechanical issues, as its fleet is totally interchangeable.

Southwest also uses time efficiently: It is able to unload, clean, and reload each plane in 25 minutes versus the 60 to 90 minutes its competitors take. According to an aviation consultant, Southwest's advantage of a fast turnaround is by virtue of generating revenue, not cutting costs (Finney, 2006). This fast turnaround time enables the airline to fly its planes for 10.8 hours per day versus a traditional airline's 9 to 9.8 hours (Barkin, Hertzell, & Young, 1995).

Unlike traditional airlines that use a hub-and-spoke distribution system, Southwest uses a point-to-point system. With a point-to-point system, a late plane affects just one plane, two pilots, and three cabin attendants—not three pilots and 9 to 12 cabin attendants (Stalk, 2006).

Other cost-saving elements employed by Southwest include low-cost landing fees at secondary airport locations and minimal in-flight amenities. This airline does not provide seat assignments, nor

does it serve sandwiches or meals on its flights. Southwest understands that its business model is based on attracting its short-haul passengers that are able to drive to their destination. Therefore, it needs to price each flight to be less than the cost of driving the route. Its corporate culture is based on offering its passengers low-cost, frequent, but no-frills service.

Despite its low-cost structure, Southwest Airlines has had the highest customer satisfaction score of any airline rated by the American Customer Satisfaction Index from 1995 to 2011 (ACSI, 2014). Southwest Airlines has also been among the most consistently profitable of all large U.S.-based airlines.

Aldi, Vizio, and Southwest share a number of common characteristics (see Table 1):

- Cost cutting in areas where consumers are willing to accept trade-offs between lower prices and lower service levels. These 'good enough' products offer compelling value propositions to their target customer group.
- The use of simplified business models based on operational efficiencies and reduced capital requirements.
- The demonstration of high product quality through guarantees and customer and/or impartial reviews.
- The avoidance of a direct frontal attack on key established competitors.
- An organizational culture that focuses on producing affordable products through frugality, efficiency, and effective cost controls. This culture does not change as the company grows and matures.

Table 1. Common elements in the low-cost strategies of Aldi, Vizio, and Southwest Airlines

Cutting costs where consumers are willing to accept trade-offs
- Aldi's in-store efficiencies (refusal to accept credit cards; the absence of shopping bags and baggers)
- Aldi's high concentration on private label sales
- Vizio's concentration on sales through warehouse clubs
- Southwest Airlines' lack of seat assignments and meals

Using a simplified business model
- Aldi's low rental and fixturing costs
- Aldi's 1,400 versus 40,000 SKUs at the average supermarket
- Vizio's low staffing and capital needs due to outsourcing parts manufacturing and assembly
- Vizio's sale of televisions through warehouse clubs with lower profit margin requirements than traditional electronics retailers and box stores
- Vizio's strategy of minimizing inventories
- Southwest's use of one aircraft type
- Southwest's quick turnaround time
- Southwest's point-to-point distribution system

Demonstrating quality through guarantees and impartial reviews
- Aldi's blind taste testing reviews
- *Consumer Reports'* evaluation of Vizio television models as best buys
- Costco's 90-day return privileges and 2-year extended warranties on Vizio televisions
- Southwest Airlines' high rankings on the American Customer Satisfaction Index

Avoiding a direct attack on key competitors
- Aldi's use of low-rent locations where there are no adjacent competitors
- Vizio's sales through warehouse clubs
- Southwest Airlines' use of peripheral or second-tier airports and avoidance of airline hubs of established competitors

Having an organization culture based on frugality, efficiency, and cost controls
- Aldi's culture of extreme frugality and the desire to be simple, cheap, and good
- Vizio's desire for creating leading edge but affordable products
- Southwest Airlines' low prices to attract passengers who currently drive rather than fly
- Southwest Airlines' desire for frequent but no-frills service

It is important to note that these firms used a multiple factor approach to cost reduction. The strategy used to achieve cost reduction was not as simplistic as offshore production, outsourcing, or freedom from union contracts. Each firm also took an approach to cost cutting that did not significantly reduce a product's quality or customer satisfaction. The multiple factors used to achieve low costs, extreme value, and high levels of customer satisfaction are not easily copied by traditional competitors.

4. Strategic options for responding to low-cost competition

Established firms can respond to low-cost competitors via one of four overall strategies (see Table 2):

1. waiting and watching;
2. keeping the current pricing strategy without matching new competitors' price levels;
3. matching or coming close to low-cost competitors' price levels; or
4. developing a new fighter (fighting) brand or private label brand to be sold along with their traditional brands.

Regardless of the alternative chosen, the first necessary step is to identify potential competitors.

In some mature industries, established firms were so busy competing with other large firms that they ignored small upstart competitors that would eventually become key competitors. Ericsson, Alcatel, Lucent, and Nortel were too busy competing against each other in mobile telecommunications businesses to recognize Huawei as a threat (Ryans, 2009). Likewise, Nokia focused too much attention on Motorola, and Caterpillar paid too much attention to Komatsu and not enough to low-cost competitors.

In some instances, the successful low-cost competitors were off the radar screen of entrenched competitors, as they were initially small companies

Table 2. Appropriate demand, cost, and competition environments for specific competitive response strategies

(1) Waiting and watching
- The new low-cost competitor is underfunded and requires significant additional capital to grow.
- The firm has significant switching costs to adopt new low-cost technology.
- The new low-cost product requires new distribution channels, service centers, and financing arrangements to be effective. These facilities and processes will take a sufficient time to become operational.
- The existing firm is cautious and wants to make an informed decision as to which strategy it should take.

(2) Keeping the current pricing strategy
- Existing firms have strong brands.
- Existing firms offer differentiated goods and services.
- Traditional firms have an established brand positioning and corporate culture that stresses product and service quality.
- Existing firms are able to document overall cost savings over new competitors due to manufacturing, operational, and logistics efficiencies.
- A large segment of consumers are not price conscious.
- Low prices have little impact on expanding the overall market for a good or service.
- Traditional firms fear competitive convergence.
- Traditional firms can match prices selectively using yield management pricing and unbundled pricing.

(3) Matching or coming close to low-cost competitors' price levels
- The product quality and service levels of low-cost innovators and established firms are viewed as undifferentiated goods and services.
- A large and growing segment of price conscious consumers exists.
- Significant economies of scale exist.
- Decreasing price levels may drastically expand the overall market for a good or service.

(4) Developing a new fighter brand or private label
- There is high overlap in component parts across fighter and premium brands.
- Economies of scale exist.
- Multiple brands give a firm high bargaining power.
- A firm can now use existing factories at full capacity.

based in China and India or were U.S.-based firms with a limited market presence, like Wal-Mart and Target. In other instances, the low-cost startups were privately held companies that did not publicly disclose their sales and profit data. Lastly, some low-cost firms have so drastically changed direction and markets that it would be difficult for established firms to anticipate their success.

Low-cost competitors have often emerged in mature industries as a result of seeing opportunities due to high current market prices. Some industries that are vulnerable to new competition due to high market prices are college textbook publishers, gourmet coffee producers, and budget hotels that now charge over $100 per night.

4.1. Waiting and watching

A 'wait and watch' approach enables a traditional competitor to carefully monitor the success of a low-cost competitor prior to determining its competitive response. A traditional competitor should list specific benchmarks for a low-cost firm and develop an appropriate competitive response for each benchmark.

Existing firms using a wait and watch strategy need to carefully monitor the potential impact of low-cost competitors. Early signs of success for a low-cost competitor include recent plant or store expansions, the licensing of important technology from patent holders, long-term agreements with supply chain partners, superior product reviews from trade media, receipt of major funding, and the hiring of seasonal professionals. Obtaining this information may be difficult if the low-cost competitor is privately held or foreign owned, or is a newly established firm. In some cases, relevant information can be obtained by carefully monitoring the trade press as well as local media in towns and cities where the low-cost competitor is based. In other cases, syndicated data may be available that tracks sales and market share by vendor.

While a low-cost competitor may want to promote its expansion and success, it needs to be aware that these actions may alert established competitors. For example, a traditional competitor may elect to implement a revised pricing strategy when the low-cost competitor gets significant funding, receives a major contract, hires key personnel, obtains a market share of 10%, or receives or licenses important technology.

One way of preparing for a new low-cost competitor is a 'beat my business' exercise in which cross-functional teams of the established firm meet to discuss how they would effectively compete with a new low-cost entrant. In this exercise, each team looks at the strengths and weaknesses of their own company relative to the new entrant's. As an example of a beat my business exercise, the president of Electrolux held a series of workshops to better understand Samsung and LG. A team of Electrolux executives role-played the LG team in developing ways to beat Electrolux. Electrolux then took these strategies into account. The use of beat my business has the advantage of identifying potential competitors, planning appropriate strategies, and determining a timetable that provides established firms with ample time to respond (Gluckman, 2012).

While the wait and watch strategy is a cautious approach, waiting and watching too long can enable the competing low-cost firm to grow. Since many low-cost competitors are small, inexperienced, and not adequately funded, they are most vulnerable to competitive pressures during the wait and watch time period.

4.2. Keeping a firm's current pricing strategy

Established firms with strong brands, highly differentiated goods and services, and/or complex products are the most likely to find success with the strategy of keeping current pricing and not directly competing against low-cost competitors. This strategy is also appropriate in situations in which a large segment of consumers is not price conscious and low price levels have little impact on expanding the overall market for a good or service.

Firms keeping their current pricing strategy need to be aware of the denial trap (Kachaner et al., 2011). This trap causes some established firms to chronically underestimate the potential of the new low-cost competitor by overestimating their own brand loyalty, customers' switching costs associated with changing suppliers, and/or the value of the brand name or customer service levels.

A firm that decides to retain its current pricing strategy needs to objectively evaluate its value proposition from the perspective of its customers. The higher priced firm also needs to effectively communicate its advantages. SKF, a major manufacturer of bearings and related products, provides customers in some of its markets with an estimate of the return on investment they can earn from purchasing its products. These estimates are based on hundreds of documented client-based case studies. In some instances, SKF will guarantee part of the return on investment (Ryans, 2010a).

Some established firms have chosen not to compete on a price basis due to the difficulty in

reducing costs. Even after paying close attention to cost-cutting, there is a significant chance that firms will be unable to match their low-cost rivals' cost structures. Unions, old inefficient domestic plants, and higher customer service levels may make it difficult for a traditional firm to match a low-cost competitor's cost. In addition, a firm's assets may be tied to specific technologies, tasks, products, and location (Maitland & Sammartino, 2012). Still other firms may decide not to directly compete using a pricing strategy for fear of the effect on profits as well as the effect on brand image.

Competitive convergence is another negative issue associated with price matching. As a consequence of competitive convergence, products—regardless of manufacturer—may begin to resemble each other as one difference after another fades away. Eventually nothing but price remains as the basis for a customer's choice, as the products of all manufacturers resemble undifferentiated commodities (Porter, 2011).

4.3. Matching or coming close to low-cost competitors' price levels

With a matching strategy, established firms can choose to directly match low-cost firms' price levels or significantly reduce their own price premium relative to their low-cost competition. The need to match the low-cost competitors may be intensified when the current premium segment is growing slower than the discount segment, or when an established firm seeks to deter a new low-cost competitor's growth.

Matching or coming close to low-cost competitors' price levels is appropriate for markets with the following characteristics: a large and growing segment of price-conscious consumers, significant economies of scale, firms that offer undifferentiated goods and services, and decreasing price levels that can drastically expand the overall market for a good or service. This strategy also makes sense when a firm can identify and reduce major inefficiencies in production and marketing or costly features that do not add value to the customer.

Tough competitive reactions such as price-matching policies, everyday low pricing, and cornering key resources (e.g., airline slots at capacity-controlled airports) can limit a low-cost competitor's growth rate. Firms adopting a strong competitive response need to be aware of potential antitrust issues associated with selling goods below cost and with matching prices in selective markets. In addition, firms that plan to launch a low-cost venture should be motivated by making profits, not as a defensive means to blunt a low-cost competitor's strategy (Kumar, 2006).

An alternative to directly matching low-cost competitors' prices is for the established firm to selectively match prices through either yield management or unbundled pricing. In yield management pricing, a service marketer continuously updates its price levels based on evaluations of reservations against a projection of demand for each time slot. The fundamental objective of yield management pricing is to adjust prices to fill all available capacity (Berman, 2005). Yield management is particularly effective as a price-matching strategy in cases in which the capacity of low-cost competitors is severely limited and different market segments have different price elasticities.

Unbundled pricing also enables a firm to selectively vary prices. It enables a traditional competitor to have customers select and pay for only those services they desire. Unbundled pricing is particularly effective when different market segments desire—and are willing to pay—higher prices for added service levels.

4.4. Developing a new fighter brand or private label brand to be sold along with its traditional brands

The strategy of developing a new fighter brand to be sold along with traditional brands combines elements of two other strategies: keeping the current pricing and matching low-cost competitors' pricing. By keeping the current pricing, the traditional brand keeps its current loyal customers, provides high profit margins, and retains its current image. By also developing a fighter brand, the firm competes directly with low-cost competitors' products, slows competitors' growth, and provides access to a fast-growing market.

Marketing both fighter brands and traditional brands at the same time represents some unique challenges. Each brand needs a distinct value proposition: The more distinct the product quality, ordering process, and service levels, the more a firm can avoid cannibalization. Firms should consider actively disabling some product features and product support capabilities on its fighter brand to further distance it from its premium brand (Ritson, 2009). Alternatively, a firm can increase the product and service quality on its premium brand to reduce the effects of cannibalization.

Dow-Corning has two brand designations for its commodity silicone-based specialty chemical products: Xiameter, its fighter brand, and its Dow-Corning premium brand. Its fighter brand enables the company to be more price competitive without hurting the

Dow-Corning image or brand. Unlike the Dow-Corning brand, Xiameter offers no technical support, requires large order sizes, has extended delivery times—as Xiameter's products are manufactured only at times when Dow's factories are idle—and offers short payment terms. To further reduce ordering costs and to distinguish service levels between both brands, Xiameter's entire sales order cycle process is fully automated, from order placement to order acknowledgement, confirmation, and electronic invoicing (Gary, 2005; Kumar, 2006). The Xiameter product line was so successful that within 3 months of being launched, Dow Corning's total investment was paid back (Anthony, 2008).

3M uses its fighter brand Highland as an alternative to dropping prices on its flagship 3M brand. To distinguish between its fighter and traditional brands, Highland is available in fewer choices, uses a lower grade adhesive, and—unlike 3M's traditional brands—does not offer trade promotions. According to one source who has studied 3M, Highland's lower quality means lower costs; this ensures that Highland is very profitable to 3M despite its lower price (Ritson, 2009).

A manufacturer can also choose to produce a line of private label products as an alternative to a fighter brand. The private label strategy leaves the marketing responsibility to resellers, and provides no direct association with the manufacturer's traditional brand from a consumer's perspective. Like a fighter brand strategy, a successful private label can target a firm's goods and services at a new market segment, can utilize a firm's excess capacity, and can effectively compete with a low-cost competitor.

Unlike the private label brand, a fighter brand enables a manufacturer to better control the quality, performance, and features gap between its multiple brand offerings. High quality and feature overlap between the manufacturer's brand and the private label could greatly increase the level of cannibalism between both products. In addition, the fighter brand strategy is more difficult to plan and implement due to the lower level of reseller support.

5. Summary and conclusions

New low-cost innovators have succeeded using simplified business models based on low operating and capital costs, outsourcing, producing good enough products, and purchasing the right to use technology rather than developing patents. In some cases, the price levels were so attractive that goods and services originally aimed at specialized markets became mass market-based, like Haier's low-cost wine refrigerator. In other instances, the low-cost models resulted in consumers being willing to accept lower service levels as a trade-off for lower prices.

Of the four competitive response strategies studied, wait and watch is the easiest to implement. While a long-term wait and watch time period enables existing firms to better understand a new competitor's impact, it gives the new competitor ample opportunity to establish itself.

The strategy of keeping a firm's current price structure is most appropriate for markets characterized by strong brands in four situations: existing firms offer highly differentiated goods and services, products are complex, a large segment of consumers is not price conscious, and low price levels have little impact on expanding the overall market. Too many firms seek to match, as opposed to coming close to, low-cost competitors' price levels. With a coming close strategy, an established firm should monitor low-cost competitors' prices and determine an appropriate price premium based on its competitive advantages.

Firms using the matching pricing strategy need to recognize the difficulties in matching the cost structure of their newer low-cost competitors. Unlike the new entrant, the traditional firm may have contractual relationships with vendors including unions, property owners, and suppliers; a corporate culture based on full service and very high levels of product quality; and complicated and costly business models. In addition, its assets may be tied to specific technologies, tasks, products, and locations.

Marketing both fighter and traditional brands combines elements of keeping the current pricing strategy (through continued use of its traditional brands) and matching low-cost competitors' strategies (through developing a new fighter brand). This is the most difficult strategy to implement, as it involves the added costs of developing, maintaining, and sufficiently differentiating each brand.

Table 3 contains a series of questions that a traditional competitor needs to answer before developing each of its competitive responses: (1) waiting and watching, (2) keeping the current pricing strategy without matching new competitors' price levels, (3) matching or coming close to low-cost competitors' price levels, and (4) developing a new fighter brand or private label brand to be sold along with its traditional brands. The answers to these questions need to be formulated by a committee consisting of the CEO and the top executives from production, marketing, finance, human resources, and the firm's general counsel, as these

Table 3. A competitive response checklist

Answer "Yes" or "No" to each question:

For firms considering the wait and watch strategy:
Does your firm:
- Identify which emerging firms are most likely to become key competitors?
- Track emerging competitors using consumer trial rate, consumer repurchase rate, loss of key customers, and other relevant metrics?
- Assess major limitations to the emerging competitor's growth by virtue of its capitalization, presence in a niche market, distribution intensity, etc.? And then evaluate how these limits could be overcome?
- Study the pros and cons of tracking an emerging competitor for too long a time period versus quickly responding?

For firms considering not directly matching the low-cost rival's price:
Does your firm:
- Assess its full-priced brand's value proposition strength relative to its low-cost competitor(s)?
- Study how its full-priced brand's value proposition can be increased via ease of use, styling, ease of repair, product and service guarantees, etc.?
- Develop comparative advertising campaigns to show the relative advantages of its brands in comparison to low-cost competitors?

For firms considering matching or coming close to a low-cost competitor's prices:
Does your firm:
- Study customer-based value proposition trade-offs between lower prices and lower service levels?
- Assess whether its customers' value proposition trade-offs vary by market segment?
- Evaluate its customers' basic requirements for good-enough products?
- Assess whether customers' good-enough product requirements vary by industry or market segment?
- Determine which elements of low-cost competitors' business models can be adopted?
- Study whether it could renegotiate its contracts with unions, property owners, and suppliers to become more cost effective?
- Evaluate the pros and cons of organically developing low-cost products as opposed to acquiring them?

For firms considering marketing both fighter and traditional brands:
Does your firm:
- Evaluate the strength of its fighter brand's value proposition compared to low-cost alternatives from other firms?
- Study the distinct value proposition of each brand?
- Assess whether its fighter brand's quality and service levels fall short of its premium brand(s) to reduce cannibalism across brands?

questions have broad sweeping effects on a firm's long-term strategy.

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