# Escaping the commodity trap –

How to regain a competitive edge in commodity markets

Study results



Stuttgart, April 2014







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### Management summary

#### Study results:

- > A "commodity trap" describes a situation where even complex products and services are downgraded to "commodities", with limited differentiation and where competition is primarily price-based this is due to a combination of developments experienced by customers, competitors and in products/technologies
- > The commodity trap is a phenomenon found in all industries over 60% of the study participants have been affected, 54% have yet to take sufficient action to escape (and among affected companies even 65%). At many companies, there is a significant gap between recognizing the commodity trap and reacting accordingly
- > In most industries, commoditization already started some 5 years ago almost all industries report their low-end market segments as being affected, more than half of the participants also see their middle segments being hit and about 20% face commoditization even in their premium segments
- > Key levers used to escape the commodity trap include innovation, quality and business model actions the biggest gaps between a lever's effectiveness and its application are seen in the levers business model alignment and target costing/design-to-cost

#### Consequences from the Roland Berger perspective:

- > Actions designed to escape the commodity trap depend on whether the commodity trap is pending or whether a company has already fallen into it thus, actions can be for the short, medium or long term, and taking preventive rather than reactive action provides much greater leeway
- > Successful **short-term actions** include tactical marketing/sales activities, whereas **medium-term actions** include changes in product or market positioning as well as quality and cost actions **long-term activities** include portfolio realignment and changes to the business model

A. Study results –

 Commoditization is threatening many industries









# A commodity trap is a situation where products and services have slipped into purely price-based competition

Definition of "commodities" and a "commodity trap"

- > "Commodities" are products and services that
  - Have a high level of standardization (quality, technical features, etc.)
  - Face intense competition with comparable, substitutable products/services
  - Are subject to major price transparency for customers, usually in a buyers' market
- > The "commodity trap" is a situation where providers of "commodity" products or services find themselves facing
  - Increasing price and margin pressure
  - New market players, often followed by production overcapacities
  - A downward spiral of purely price-based competition and no escape by traditional means of standing out from the competition



















# The majority of companies are facing the commodity trap but have yet to take sufficient counteraction

Roland Berger survey: "Escaping the commodity trap" – Overview of results

63%

Of all companies are facing the commoditization of their products and services

61%

Of all companies see their products and services already caught in the commodity trap

54%

Of all companies realize that they have not yet taken sufficient action to escape the commodity trap





# 65% of the companies that see their products and services caught in the commodity trap fail to take sufficient action to escape

Roland Berger survey: "Escaping the commodity trap" – Overview of results

61%

Of all companies see their products and services already caught in the commodity trap

Thereof

35%

Believe they are taking sufficient action to escape ...

65%

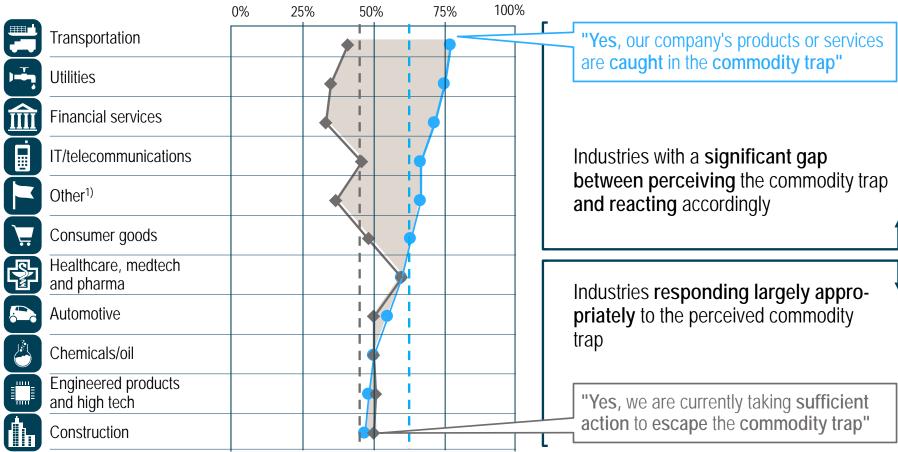
not yet taken sufficient action to escape ...





## Several industries are facing a significant gap between recognizing the commodity trap and reacting accordingly

Perception of a commodity trap and reaction per industry



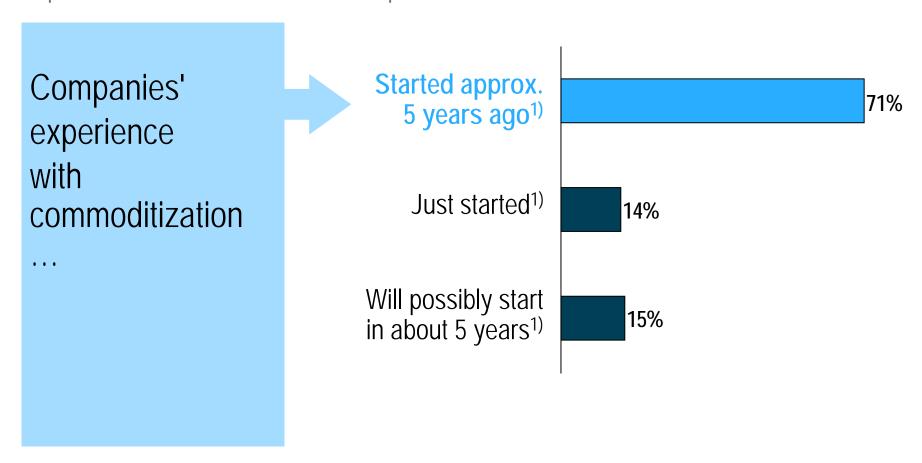
1) Publishing, media, professional services, etc.





## Most companies started seeing the commoditization of their products and services already some 5 years ago

Experience with commoditization of products and services



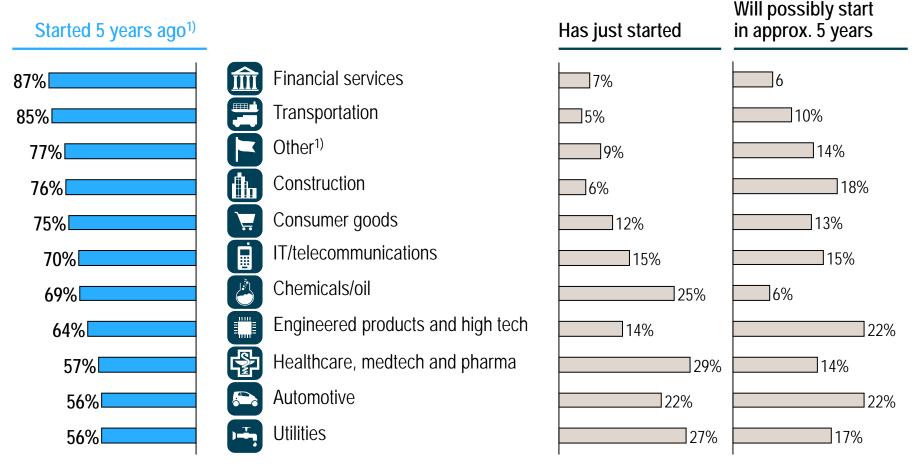
<sup>1)</sup> Share of answers that described the level of agreement with the statement as (5) very high or (4) high; on a scale of (1) very low to (5) very high





### Most industries already started seeing commoditization about 5 years ago – By now, basically all industries have been affected

Our experience with commoditization ...



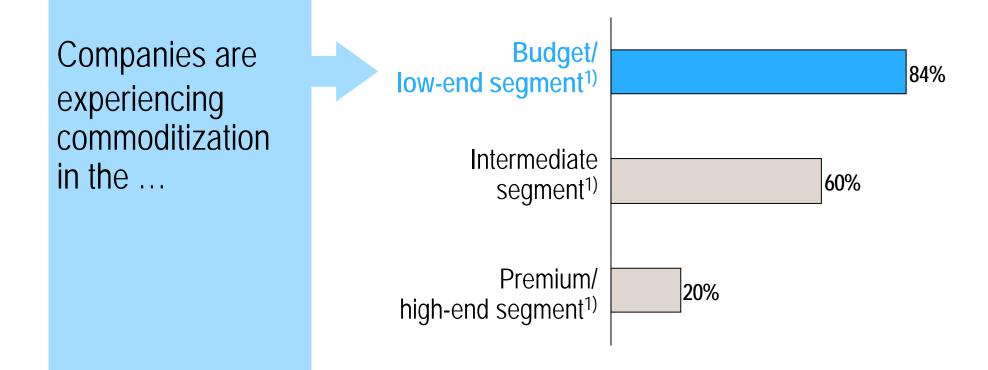
<sup>1)</sup> Publishing, media, professional services, etc.





# Commoditization widespread in low-end and mid-market segments – Some 20% of companies facing this even in the high-end segment

Market segments affected by commoditization



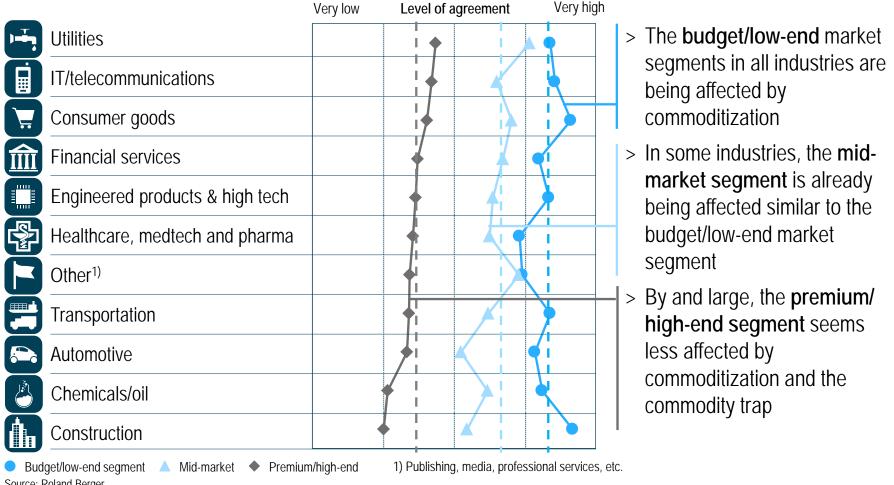
<sup>1)</sup> Share of answers that described the level of agreement with the statement as (5) very high and (4) high; on a scale of (1) very low to (5) very high





### In most industries, commoditization affects mainly the budget market segments – But some struggle even in the premium segment

Market segments affected by commoditization broken down by industry

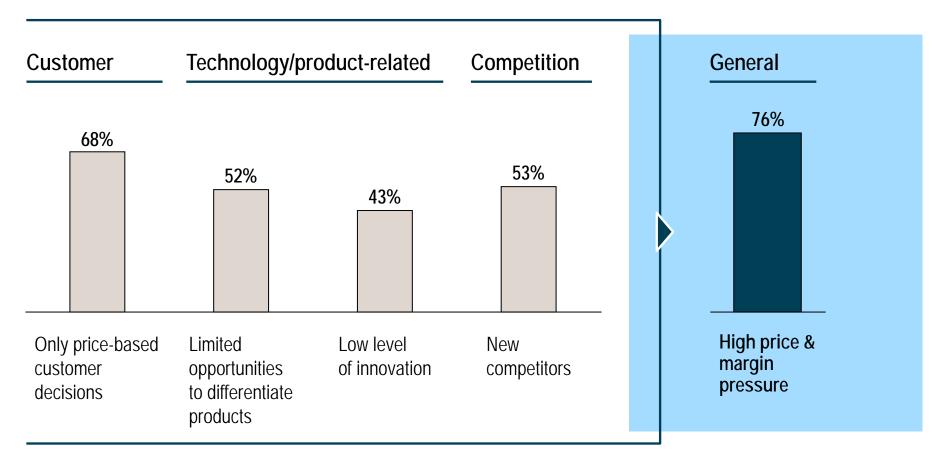






## Price-related aspects are viewed as the most significant indicators of a commodity trap across industries

Indicators of a commodity trap across industries<sup>1)</sup>



<sup>1)</sup> Share of answers that described the level of agreement with the statement as (5) very high and (4) high; on a scale of (1) very low to (5) very high





### Almost all levers used to escape the commodity trap exhibit a gap between their level of application and their perceived effectiveness

Effectiveness and current application level of levers to escape the commodity trap

	Very Iow	Level of effectiveness/ application	Very high
Use innovation to differentiate products		<b>*</b>	
Upgrade/bundle products with services		4 7	
Improve product and delivery quality			
Strategically align the business model		4	
Strengthen target costing/design-to-cost		<b>A</b>	
Create a suitable organizational basis to <b>react flexibly</b> to strategic challenges			
Apply marketing and sales tools			
Shift toward specific market segments			
Strategically align portfolio			

- > For almost all levers, the current level of application does not correspond to their perceived effectiveness
- Innovation and qualityrelated levers are viewed as the best way to escape the commodity trap
- > The largest gap between effectiveness and level of application is seen for the business model alignment lever

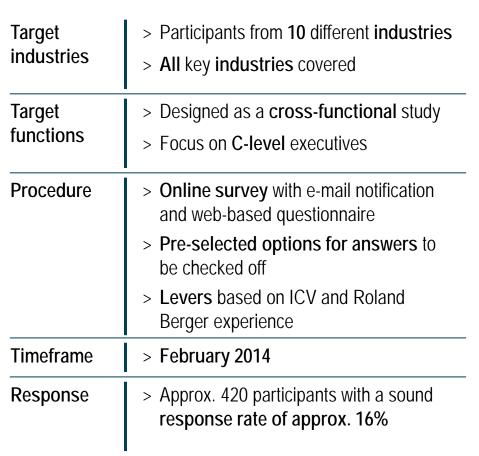
● Effectiveness ▲ Current level of application

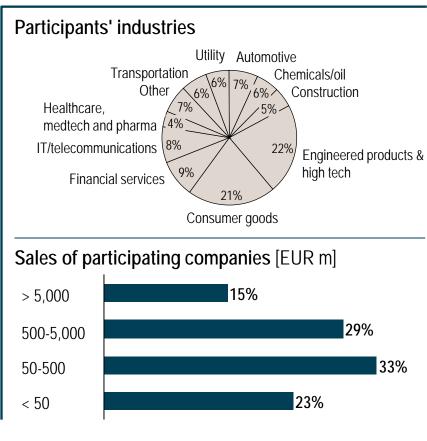




## We designed the commodity trap survey as a joint study by ICV and Roland Berger – All key industries are represented

#### Survey focus and responses





B. The commodity trap –
Root causes, elements
and symptoms from the
Roland Berger
perspective

Roland Berger Strategy Consultants





# Root causes of the commodity trap are driven by global megatrends – Three interlinked elements and three ways of falling into the trap

Three global megatrends are pushing companies into the commodity trap

#### Root causes

#### Changing demographics

Globalization and future markets

Scarcity of resources

The challenge of climate change

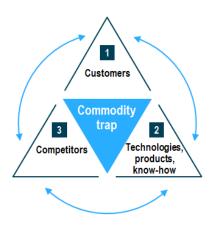
Dynamic technology and innovation

Global knowledge society

Sharing global responsibility

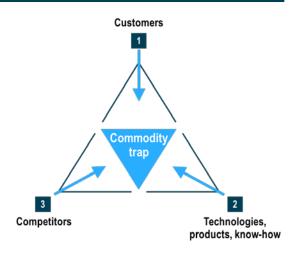
- > Three out of seven global megatrends contribute to the root causes of commoditization
- Their impact on the global economy triggers the commodity trap

#### Elements of a commodity trap



- > There are three interlinked elements of a commodity trap
- Various indicators per element signify the existence or emergence of a commodity trap

#### Ways to fall into the trap



- The slide into the commodity trap can start at any of the three elements
- > These **elements reinforce** each other
- > Result: significant price and margin pressure



## Root causes of commodity traps lie in global megatrends that cannot be influenced by a single company

Global megatrends and selected symptoms of commoditization

Changing	demographics
Ondriging	acmograpmos

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

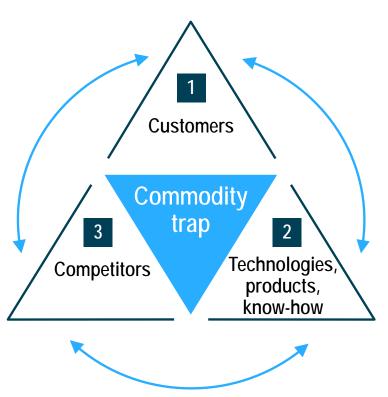
Changing customer perceptions of value

Newly established price transparency



## Commodity traps have three interlinked aspects – Various indicators signify the emergence of a trap

Elements and indicators of the commodity trap – Selected aspects

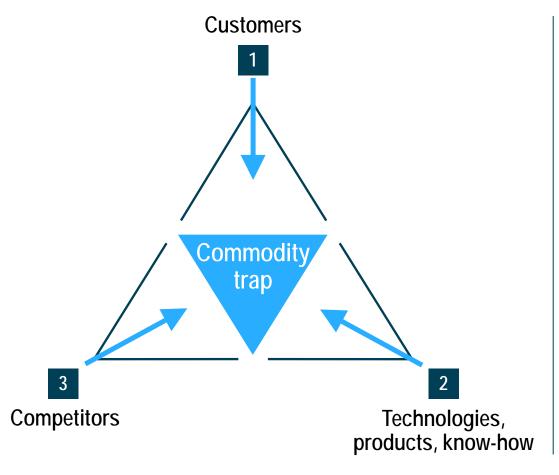


- > Transparency of product/service features, pricing and cost
  - > Globally accessible supply markets
  - > Changed customer perception of value away from differentiation
  - > Decreasing customer loyalty
  - > Price-based buying decision Purchasing decides on supplier
- > Technological maturity, i.e. 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)
- 3 > 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

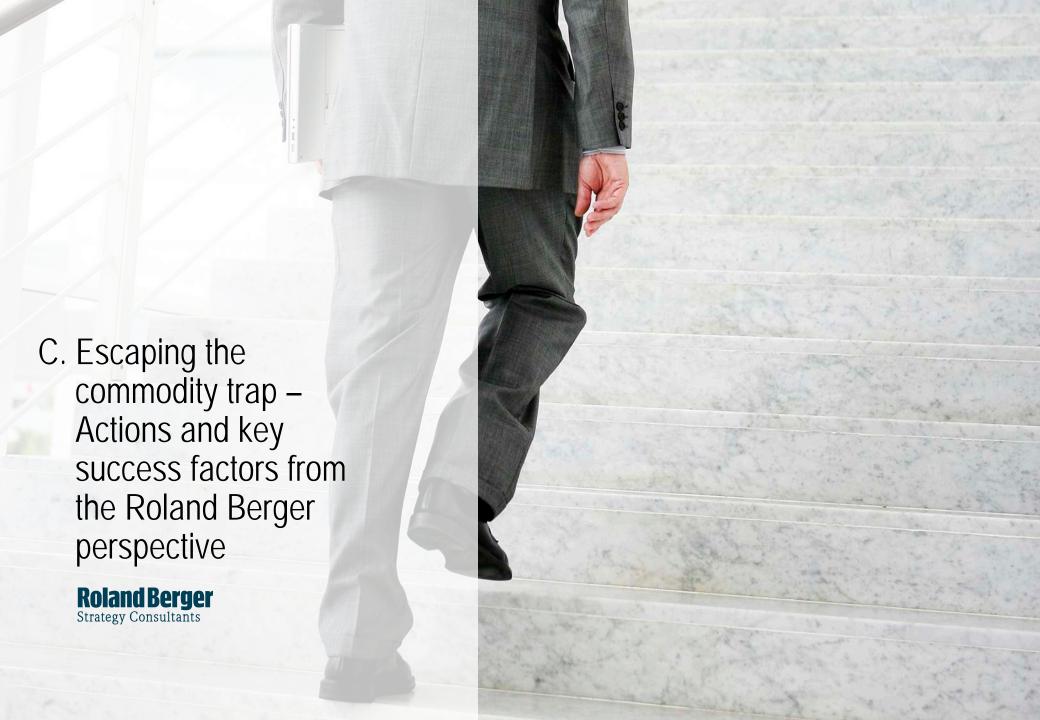


### The fall into a commodity trap can start with any of the three elements – Price and margin pressure is the ultimate outcome

Ways into the commodity trap



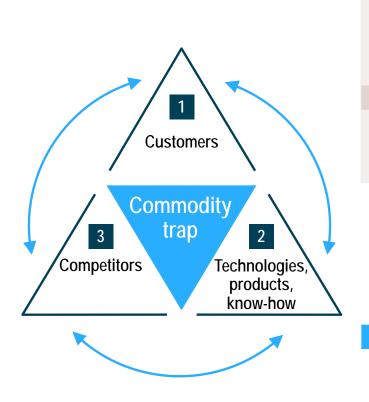
- > Commoditization can start at any of the three elements of the trap
- > Elements reinforce each other, e.g.
  - Technological progress leads to standardized, easy-to-manufacture products or components
  - New players, also from developing countries, enter the market
  - Customers rarely differentiate 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





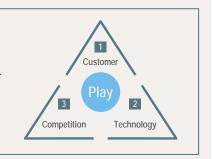
## There are two ways to react to the commodity trap – Only "changing the rules" promises sustainable competitiveness

Commodity trap and consequences



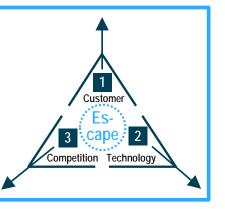
#### Option I: "Play by the rules"

- > Compete within the commodity trap, i.e. through price
- > Increase size and realize economies of scale
- > Restructure and cut costs



#### Option II: "Change the rules"

- > Escape the commodity trap by changing the rules of the game
- > Tackle all three elements of the commodity trap and their indicators
- Select and implement an appropriate set of counteractions, including changing the business model

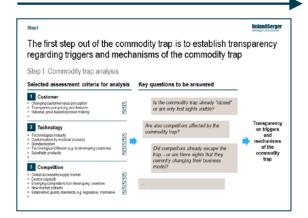




## "Changing the rules" requires three steps: Analyze the commodity trap, select lever(s) and define company-specific counteractions

The way out of the commodity trap – Overview

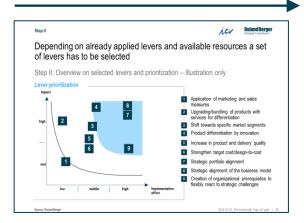
### Step I: Analyze the commodity trap



- Establish transparency regarding status, elements and mechanisms of commoditization
- This requires carefully evaluating the triggers that have caused the trap

#### Step II:

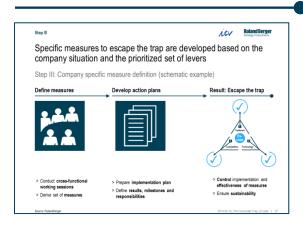
#### Select lever(s)



- Select an appropriate set of levers depending on which have already been applied, what impact should be achieved, and what resources are available
- Consider and analyze similar examples from competitors or other industries

#### Step III:

#### Define specific actions



- Specific counteractions are to be defined and detailed based on the commodity trap characteristics and selected levers
- > The way out of a commodity trap will be different for each company, as it depends on the company's core competencies and characteristics



# The first step out of the commodity trap is to establish transparency regarding the triggers and mechanisms of commoditization

#### Step I: Commodity trap analysis

#### Selected assessment criteria for analysis

#### 1 Customer

- > Changing customer perceptions of value
- > Transparency on pricing and features
- > Rational, price-based decision making
- > etc

#### 2 Technology, products, know-how

- > Technological maturity
- > Customization through modular products
- > Standardization
- > Technological diffusion (e.g. to developing countries)
- > Substitute products
- > etc.

#### 3 Competition

- > Globally accessible supply market
- > Excess capacity
- > Emerging competitors from developing countries
- > New market players
- > Established quality standards, e.g. legislative
- > etc.

#### Key questions to be answered

Which elements of the commodity trap are affected? Which indicators can be measured or observed?

Are all competitors affected by the commodity trap?

Have competitors already escaped the trap? If so, how?

Which product and market segments are affected?

etc.

Transparency regarding indicators and mechanisms, and status of the commodity trap



## A wide range of levers is available to pave the way out of the commodity trap

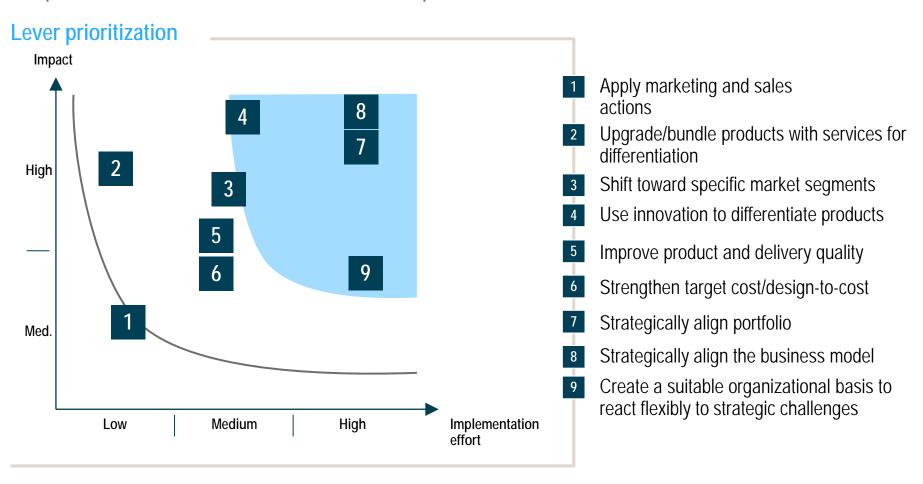
Step II: Overview of selected levers

	Levers	Examples
term according term according to the second	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
Med term	3 Shift toward specific market segments	Specific products for developing countries, high-end customers, etc.
levers 4	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



### A set of levers has to be selected based on the desired impact and the available resources

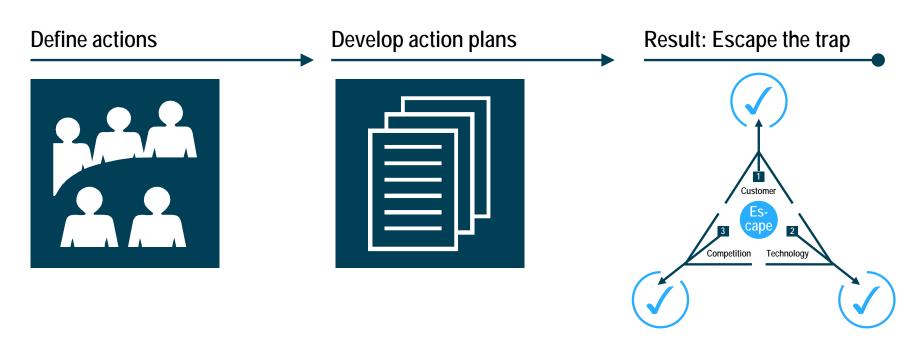
Step II: Overview of selected levers and prioritization





### The specific actions for escaping the trap need to be developed based on the company's situation and prioritized set of levers

Step III: Company-specific action definition (example)



- > Conduct cross-functional working sessions
- > Derive a set of actions

- > Prepare implementation plan
- > Define results, milestones and responsibilities

- > Monitor implementation and action effectiveness
- > Ensure sustainability



### 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 & 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



It's character that creates impact!

Roland Berger
Strategy Consultants