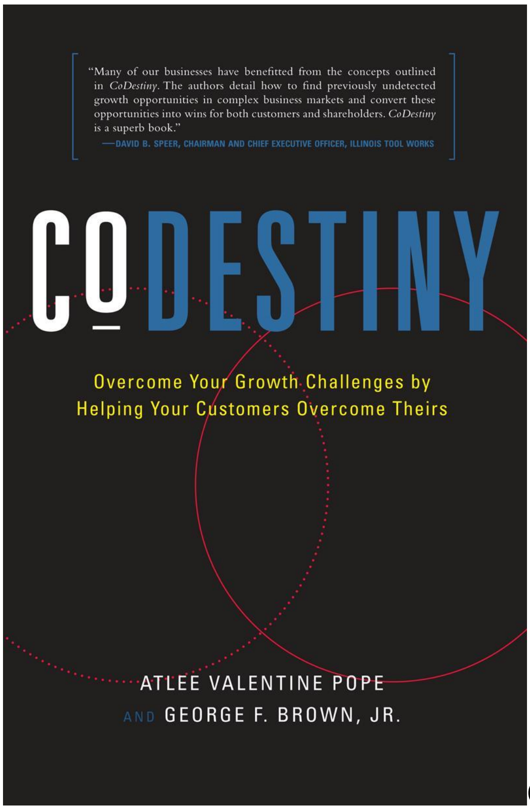
Sitting on the Bull’s-Eye

GEORGE F. BROWN, CEO and cofounder, Blue Canyon Partners Inc.

By GEORGE F. BROWN**,** CEO and cofounder, Blue Canyon Partners Inc**.**



One of my all-time favorite *Far Side*™ cartoons shows a deer with a target on its chest. The caption has another deer commenting, “Bummer of a birthmark, Hal.” In our work with firms serving business markets, we’ve come across many organizations that feel their organizations are the ones sitting squarely in the bull’s-eye, with supply chain managers and competitors alike taking aim on an ongoing basis.

The challenge faced by such firms involves the threat that they will have to succumb to the vicious cycle of price-based competition, resulting in the erosion of their profit margins and the denigration of their products to commodity status. Neither is a pleasant prospect.

There are three instances in which it’s almost always correct for a firm to assume that it’s sitting on the bull’s-eye:

1. If your firm is among the largest suppliers to a customer, assume you’re on the bull’s-eye. Your competitors are thinking, “Wouldn’t it be great to supplant them?” and the purchasing managers in the customer organization are thinking, “We’d be heroes if we can get a couple of percentage points off that bill.”
2. If your firm’s ingredients or services are among the largest elements of the

cost structure of some customer’s product, assume you’re on the bull’s-eye. Competitors think, “This is where we want to be, because that’s where the money is,” and purchasing managers see that “a dollar saved here drops right to the bottom line, and there are a lot of dollars that can be saved on that ingredient.”

3. If your firm’s products are among the highest priced products bought by a customer, assume you’re on the bull’s-eye. Competitors say, “Let’s take that high-ticket business,” and purchasing managers say, “It takes as much work to get concessions on a $1,000 product as it does on a $1 product, so let’s go for the elephants and let the ants alone.”

Over the years, on some occasions, I’ve heard executives say, “Maybe that’s true in general, but not in this instance.” In almost every case, within a year or so, I’ve gotten a call lamenting the fact that their company was now sitting on the bull’s-eye. It’s smart to recognize the inevitability of that outcome and take actions in advance so that your firm doesn’t get pulled into a vicious cycle of price-based competition. There are three actions that can be taken to improve your outlook.

The first strategy recognizes the fact that there are many instances in which price is not the most significant factor in a customer’s purchase decision. The saddest situation involves a supplier who elects to respond to a lower-price competitor by cutting price, even though the customer’s purchase decisions were based upon other factors like product technology or services. For such suppliers, their next step is usually degrading their product and service to avoid cutting into their profit margin. This is an instance of using both edges of a double-edged sword to cut your own throat — one edge was participating in a vicious cycle of price-based competition unnecessarily, and the other edge was downgrading your position to that of competitors by cutting back on the product and service elements that allowed you to be successful in the first place.

One firm in the tool market had been responding with price reductions to ever-tougher challenges from low-price imported tools. When it studied its market carefully, it learned that there was, in fact, one segment of tool buyers that made their purchase decisions on the basis of price. But there were other segments where product features and services were far more important. The responses this firm was making to the challenge in the price-focused segment were exactly the opposite of what was required for success in the other market segment. When the firm redirected its strategy to product enhancements and collaborated with its dealers on service improvements, it was able to gain market share at premium prices, despite the ongoing presence of the low-priced tools.

Even when you are sitting on the bull’s-eye and the arrows are coming your way, not all of them are going to hit. Be aware of when price is a critical factor and when it is not. In the latter instances, your strategy should be to emphasize the factors that set your firm and your products apart from the bare-bones, low-priced alternatives. And, like the tool company cited in the example above, the winning strategy often involves raising the bar in terms of products and services. The worst strategy is to simply respond to the basis of competition your competitors have selected.

The second approach to preempting the problems associated with sitting on the bull’s-eye focuses on anticipating challenges and taking proactive steps to thwart them. A simple version of this strategy says that it’s always smart to anticipate future price competition, and always smart to have a plan already implemented to avoid problems when it happens.

One firm with which we’ve worked puts into place a value engineering study on the day each significant contract is won. The purpose of this is to identify how this firm can get to a lower price point over the life of the contract — with quite significant reduction targets given to the team assigned the project. As options are identified, this firm does two things: It implements them, and it goes to its customers with good news about the price path that can be achieved through ongoing collaboration. Rarely has this firm ever had to respond after the fact to a competitor’s price pitch or to supply chain managers upset about how “the old prices are out of line with the market.” And in many instances, this firm has translated value engineering successes into higher margins at the same time that they’ve brought lower prices to their customers.

There are four factors that determine how severe pricing pressures will be. First is the capacity balance of both the supplier industry and the customer industry. When there is excess supply capacity in either industry, pricing pressure is likely. Second are the various forms of protection that might exist for the product line in question. Protection can range from legal factors (e.g., patents) to structural factors (e.g., high levels of investment required to enter the industry). The more protection that exists, the less likely there is price pressure.

Third are industry conditions. The faster the growth, the more important the security of supply becomes, and the less likely there is pricing pressure. Finally, the quality of the relationship between the supplier and the customer is important. While relationship can never overcome deficient products or pricing far off market, strong relationships are as important to customers as they are to suppliers. The stronger and longer-standing the relationship, the less likely that pricing pressures will translate into a lost customer relationship. For firms sitting on the bull’s-eye, knowing how severe the threat is allows a response to be calibrated to the situation.

The third strategy for managing life on the bull’s-eye is the most important of all. It involves a focus on the customer, thinking about what creates a win for the customer. There is no better way to blunt a competitive threat or to disarm a supply chain challenge than to have advocates from within the customer organization say, “This supplier is critical to us and is doing a great job.” Understanding what constitutes a great job and what creates a win for the customer is the route to creating champions in the customer organization who will make such a statement.

We worked with one company that made a control system that was used by its customers in their own equipment. When we studied the economics of these relationships, we found some customers where the total cost of the control system was as much as 20 percent of the cost of the equipment that they produced, with more than half of those total costs associated with integration and manufacturing, rather than the price of the control system.

At the other end of the spectrum, we saw other customers where the total cost associated with the control system was less than 3 percent of the cost of the equipment produced by these latter firms. This control system supplier saw a great opportunity to create a win for the customers where these total costs were high, in the 20 percent range, by reengineering their product to facilitate integration and manufacturing. When they did so, they created champions in these customer organizations and a huge barrier to competitive challenges.

In another project, we worked with a packaging supplier that saw an opportunity to bring a new packaging innovation to one of its largest customers. This innovation, in fact, cost almost 50 percent more than the previous generation of packaging. But it was a marketplace success — first validated by market research and subsequently by sales. The new packaging "jumped off the shelves" as customers saw something different and interesting. The customer that adapted this new packaging attributed a substantial gain in marketshare to the shelf appeal of the packaging, and claims that the product has had a lifecycle that has already surpassed the industry average by a wide margin. Once again, this supplier has created strong champions in this customer organization as a result of its contribution to the firm's success in its own end markets.

In a third example, a firm serving the commercial vehicles industry with a major drivetrain system developed some new technology that allowed better monitoring of the performance of the trucks on which it was installed, including helping to predict when maintenance was required to avoid a breakdown or a reduction in fuel economy. It brought this technology to the truck builders, with a recommendation that they offer it as an option to fleet buyers at a premium price for those that selected this option. That avoided the problem of forcing the truck builders to raise their base prices, while still giving the fleets the opportunity to benefit from this new technology.

At first, take-up was modest, with only a few fleets selecting the option. But very quickly, these sharp-pencil buyers in the fleet organizations realized that the benefits from this technology dwarfed the cost of including it as an option. As that happened, the option became more and more positive, with the truck builders, the fleets and the drivetrain supplier all coming out ahead from this new technology. This firm gained strong advocates all along the customer chain, both for the technology innovation and for the strategy of offering it as an option available to those fleets that felt it made business sense.

You can sometimes transform a bull's-eye into a favorable spotlight designed to focus applause from within the customer organization when you provide your customers with an important and visible win. You can do so by helping them take costs out and improve their bottom lines, by helping them to gain new sales and improve market share, and/or by helping them get to a more profitable price point through options and trade-ups. When you can create value in one of these ways, you have the opportunity to capture it for your own shareholders.

At the beginning of this article, I cited the Far Side™ cartoon's caption: "Bummer of a birthmark, Hal." Like a birthmark, for many firms, sitting on the bull's-eye is something that can't be avoided. It's just a fact of life. But accepting the inevitability of the vicious cycle of pricing is wrong. It is not a fact of life.

There are things a firm sitting on the bull's-eye can do in order to sustain the success that got them there. This paper has outlined three strategies for managing life on the bull's-eye:

1. Focusing on the real factors that drive purchase decisions, rather than assuming it is always about price;
2. Understanding how strong pricing pressures are likely to be and taking proactive efforts to get ahead of price challenges; and
3. Learning what creates a win for customers and transforming the bull's-eye into a spotlight on the firm deserving of applause. Those firms that learn and implement these lessons can join those that can just enjoy the humor associated with the Far Side™ cartoon rather than having to bemoan the analogy to their own sad situation.

George F. Brown, Jr. is the CEO and cofounder of Blue Canyon Partners Inc., a consulting firm working with leading business suppliers on growth strategy. Along with Atlee Valentine Pope, he is the author of CoDestiny: Overcome Your Growth Challenges by Helping Your Customers Overcome Theirs*, published by Greenleaf Book Group Press. For more information, please visit* www.codestinybook.com *[1].*

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