



VIEWS ON NEWS

When Your Product Becomes a Commodity

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Like death and taxes, commoditization of your products is a given. Marketing professor John Quelch offers tips for delaying the inevitable and dealing with it once it arrives. Key concepts include:

- *The speed from product launch to maturity is faster than ever before.*
- *Innovate, bundle, and segment are 3 things marketers can do to delay commoditization.*
- *Managers already in a commoditized market must rethink salesforce compensation and pricing, trim costs, acquire competitors, and fire unprofitable customers.*

Editor's Note: Harvard Business School professor John Quelch writes a blog on marketing issues, called Marketing Know: How, for *Harvard Business Online*. It is reprinted on *HBS Working Knowledge*.

How often have you heard a manager blame "commoditization" for failing to deliver sales or profits? If you've heard it, you've probably wondered if it was just a convenient excuse or if the manager had a valid point.

The truth is, even when a raw material has no value added and quality standards are set by law or the industry, there is still plenty of opportunity for differentiation around availability, delivery, shipment quantities, payment terms, and all the other services that accompany the core product. Marketers must use their imagination. As the saying goes: "There are no mature products, only mature managers."

That said, intense global competition, outsourcing, and offshoring are all squeezing margins, increasing customer price sensitivity, and making it harder to sustain inter-brand differentiation. The product life cycle suggests that, as product categories mature, they become

more susceptible to the forces of commoditization. The difference today is that the speed from launch to maturity is faster than ever before.

Marketers can do three things to delay the inevitable forces of commoditization.

Innovate. A new product that better meets consumer needs, even an upgrade of an existing product, can one-up competitors and force them to invest in matching or exceeding the new specifications.

Bundle. Selling a commoditized product with differentiated ancillary services (such as after-sales service) can appeal to buyers willing to pay a premium for the convenience.

Segment. Mature markets are large markets that can be divided profitably into multiple segments. Marketers can focus on providing applications expertise for less price-sensitive customer segments for whom the product is still important.

However you approach commoditization, try to innovate at all costs.

The most overlooked investment a marketer can make in advance of inevitable commoditization is a customer relationship management system that permits computation of the profit margin associated with each customer, based on price-paid less cost-to-serve. Companies need to invest in these information systems early to have the information readily at hand once margins start being squeezed.

But how do you survive if you find yourself in a commoditizing industry characterized by me-too products, overcapacity, and frequent price cuts? How can you make money?

1. Decide which customers you do NOT

want to serve, try renegotiating prices with them and, failing that, fire them. You will lose market share but improve profitability.

2. Compensate your salesforce on profit margin, not sales revenues. A volume-based salesforce will sign up any customer, regardless of profitability. That's OK early in the product life cycle but not in maturity.

3. Trim costs and acquire competitors (with profitable customers) to extract maximum scale economies in procurement, manufacturing, and distribution.

4. If you aren't the low cost producer, complicate your pricing structures so customers can't easily make side-by-side comparisons, and provide discounts as needed of artificially inflated published prices.

Facing commoditization and non-existent product innovation, some companies retreat to serving a progressively smaller niche of price-insensitive, service-oriented customers. Others with favorable cost structures may aim to boost market share but then face the challenge of managing hybrid distribution, as some customers want to switch to buying through distributors (at lower prices) while other customers still seek direct sales support (but may not be willing to pay to cover the cost).

However you approach commoditization, try to innovate at all costs to beat it back. Because, as Peter Drucker said: "In a commodity market, you can only be as good as your dumbest competitor."

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