EXECUTIVE INSIGHTS

VOLUME XVI, ISSUE 19

BE BOLD: A Playbook for Domestic Manufacturers Facing Import Threats

Aggressive competition from global majors and smaller entrepreneurial competitors is changing the landscape for Australian suppliers of building products. Knowledge is power and survival depends on using it quickly and decisively.

In this, the first instalment of a series, we explore the competitive pressures faced by manufacturers in an increasingly globalising economy, and the essential market-facing responses to increasing pressure from overseas competition. In subsequent articles we will discuss structural responses that go to the heart of business model and competitive posture.

With increasing globalization, overcapacity in plants in low cost countries and low shipping rates, importing has now become a legitimate long-term model. Many materials are now being shipped on routes that were non-existent 10 years ago. For example, steel tube imports increased from under 20% of the Australian market in 2002 to over 50% in 2012.

Asian plants in key commodities are experiencing overcapacity. In 2013, China produced approximately 2 billion tonnes of cement from approximately 3 billion of total industry capacity. The excess capacity is roughly 100 times Australian demand. Notwithstanding plans to close plants, at an industry utilization of approximately 70%, the capacity overhang is very large.

Over in Europe and the USA, a weak local currency provided some protection against imports. But in Australia, the strength of the currency had the opposite effect. Domestic manufacturing has become increasingly expensive. Even as the Australian dollar now depreciates, the recent period of strong currency has meant that import channels have been established. Although opportunistic competition could disappear in time, importers who have invested in infrastructure and local resources are here to stay. The trend has been set.

A Threat to Domestic Manufacturers

In this environment, large and small customers intent on securing the best deal, are finding ways to access new products. A quick online search of almost any material brings up a list of willing suppliers in low cost countries.

***Be Bold:** A Playbook for Domestic Manufacturers facing Import Threats* was written by George Woods, Global Head of L.E.K's Building Materials Practice and Stephanie Newey, Partner, in L.E.K. Consulting's Sydney office. For more information, contact basicindustries@lek.com.

Domestic manufacturers are facing a raft of unprecedented threats. In some markets, the threat has been significant volume loss. In others it has been price – even relatively modest import volumes can have a massive influence on pricing in an import-parity priced marketplace.

The Fact of the Threat

Two key competitors to domestic manufacturers have emerged:

- The intrusive globalist
- The aggressive entrepreneur

Defending against them requires an understanding of their key strengths and weaknesses.

The Intrusive Globalist

Faced with depressed volumes in their home markets, some global majors have sought greener pastures in new markets, bringing with them new products or formulations, established brands and deep pockets. These new entrants are credible, hungry, and have nothing to lose in the market they are attacking.

The intrusive globalist approaches new markets in a logical fashion. They are seeking markets with strong growth, few competitors and high prices. Australia often fits the bill. In the beginning, they establish a local presence to understand the market and to connect with local channels and end users. This helps them build brand awareness locally and further understand the market.

These intruders generally will import product from regional manufacturing hubs to service demand. This allows them to further test the market with limited volumes but maintain the option to expand. Over time, they often establish or acquire a manufacturing presence, sometimes in a neighboring country.

The intrusive globalist can pursue growth and market share, but generally does not seek market leadership if this would undermine the long-term attractiveness of the country market.

These players' strengths are formidable. They have global intellectual property and brands, high quality products, deep pockets and strong supply lines.

However, they do have some vulnerabilities too. They often lack market and customer knowledge, and lack distribution infrastructure or an installer base. Furthermore, their brand awareness is generally low in comparision to local established brands.

The Aggressive Entrepreneur

Many Australian building materials markets are characterized by two or three large incumbent players who collectively account for 60-80% of volume, supplying a relatively fragmented customer base. This creates two potential sources of aggressive entrepreneurial imports – a collaboration from within the 20-40% untied market, or a single larger disaffected customer who is keen to change supply and underwrite a large import order.

The aggressive entrepreneur typically targets a narrow product range, and cherry-picks attractive market segments.

These players often assemble a cohort of like-minded entrepreneurs to underpin their volume, and establish a low cost/low capital import model, fed by trading relationships with one or more overseas plants.

They have entirely different strengths and weaknesses to the intrusive globalist.

The aggressive entrepreneur has strong local market knowledge with an existing presence and reputation in the market. They have a hunger to sell and can do this effectively through a low cost model. However they do have their shortcomings. They often have questionable product quality and low quality infrastructure due to their shallow pockets. They also provide a much narrower product range and are therefore unable to cater to specialist needs.

Both are serious competitors, however, neither is invincible. Often their value proposition is simply that they are not part of the old guard.

Figure 1

Comparing the Threat: Strengths and Weaknesses

POTENTIAL THREAT	INTRUSIVE GLOBALIST	AGGRESSIVE ENTREPRENEUR
STRENGTHS ★★★★★	• Global intellectual property and brands • Deep pockets • High quality product • Strong supply lines	• Existing presence and reputation in the local market • Hunger to sell • Low cost model • Strong local market knowledge
WEAKNESSES ★★★★★	• Lack of market and customer knowledge • Lack of distribution infrastructure/ installer base • Lack of brand awareness	• Low quality local infrastructure • Questionable product quality • Shallower pockets • Narrower range offer and service

How to Respond: A Playbook for Success

Both these threats have the potential to destabilize a marketplace There is no one-size-fits-all response to these threats. However, there are five key elements to developing the right market-facing response to increased import competition. In future Executive Insights in this series, we will explore structural responses.

1. Know your Competition:

In the Australian market, successful disruptors have rarely won through strategic surprise. Their entry strategies have actually been clear and predictable. However, the incumbents often failed to make the time and effort to understand, and then lacked the imagination to anticipate the market outcomes of such a strategy.

A lot can be learned about intrusive globalists by understanding their prior patterns of behavior. It is worth reviewing how they have entered other markets, what their competitive posture is, and how aggressive their timeframes for ROI are. Similarly, for the aggressive entrepreneur, understanding their history, motives and financial capacity whilst applying local knowledge is very valuable.

1. Case Example

L.E.K. Consulting's experience in the plasterboard marketplace has revealed that intruders without the power of a scale distribution network are often limited to a no frills or small range proposition. Therefore a "perimeter fence" can be drawn in the market, identifying those customers who are more or likely to respond positively to the intruder's offer.

Understanding the true nature of the competition and establishing a "perimeter fence" around the import threat, allows the discussion of responses to be focussed and practical. It makes the trade-offs clear in what often amounts to the decision to lose volume or margin.

2. Plan Scenarios:

It is essential to develop a locally-based scenario model to evaluate alternative strategies and end states. Some organizations are reticent to invest in this exercise because of the data challenges. However, even though the analysis will not be 100% precise, the discipline of thinking the scenarios through will identify the key levers to success and help the organizations plan ahead.

2. Case Example

L.E.K. worked with one building materials organization to determine that the most effective way of responding to the aggressive entrepreneur was to fight fire with fire. By evaluating alternative strategic responses in a dynamic scenario model, we confirmed that the loss of earnings from a local hard fight was nowhere near as damaging as the potential share loss nationally if the entrepreneur strengthened its position. As a result our client focused its energy on developing a rich understanding of the local market and its strategic boundaries. They then invested in intelligence and sales force to fight this local war.

3. Embrace the Inevitable:

It's important to be prepared to embrace a new supply chain or way of doing business; an importer may be demonstrating a fundamentally superior model. Domestic incumbents should evaluate their own sourcing strategies and understand their relative cost positions against imports. They should also treat this as an opportunity to take a hard look at their overall cost base.

3. Case Example

L.E.K. has assisted several organizations in this situation. One client consequently shelved its own plans for domestic expansion and moved to an import model. Armed with larger volumes, access to capital and its own global supply chains, this created an opportunity for a dramatically lower cost position, and a winning market position that went a long way to neutralizing the competitive threat.

This response will not be right for every situation, but, by establishing the true short- and long-run costs of an import model, domestic manufacturers can evaluate their competitive response to new supply chains and models.

We will discuss business model re-engineering in more depth in a subsequent edition in this series, but the headline imperative for successful engineering is to commit to action and move quickly. We have observed too many organizations remaining paralyzed by indecision and a bias to preserving legacy approaches.

4. Develop an utterly Compelling Customer Offer:

The most important response is to get closer to customers; they are about to receive a lot of calls from a new and aggressive sales force.

Incumbent organizations can use their superior understanding of local customer needs to innovate beyond the product into the service experience in ways it is hard for the disruptor to afford at his scale. Based on a rigorous customer research programme and an assessment of the strengths and weaknesses of the competition, the winning offer can be identified.

For one Australian manufacturer, this meant a introducing a new standard of superior service delivery with commitments to one hour delivery lead times. The new entrant could not hope to match this. For another, a training module for apprentices and seasoned professionals was their path to success.

Service features can be expensive to deliver with large fixed costs, but have the potential to deliver significant new value into the customers' business economics, and create high barriers to switching. They are also difficult for smaller competitors to cost-effectively match.

5. Attack their weaknesses:

Knowing the enemy provides an opportunity to know their weaknesses and to attack them.

Whether it's an aggressive global entrant or a local entrepreneur, to the customer they are selling an unproven proposition in a category that places great value on both manufacturer reputation and long-term commitment to the marketplace. Organizations that stand behind their product and value proposition will expose their enemies' weaknesses.

Brand is an obvious lever – a company that invests heavily in its brand, as one L.E.K. client in the chemical area has, is far more secure from imports. However, strong brands take time to build, and cannot be "retrofitted" at short notice. More immediate ways of reinforcing the local proposition include warranties and service support or solutions. Warranties allow manufacturers to claim the quality space, and trumpet problem-solving capacity. Investing in service can be challenging to execute, but can often be leveraged through existing capabilities and channels.

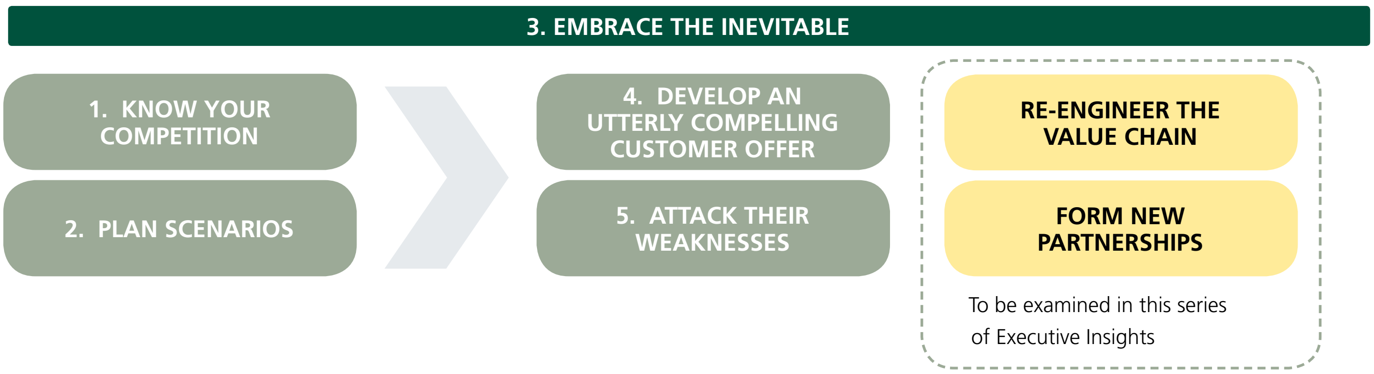
Summary

It can be challenging for management when a new competitor emerges. There can be a tendency to go into denial or to hope that the threat will go away or remain small. But organizations need to be proactive in their approach to new threats. They need to be ready and willing to make bold changes.

Domestic manufacturers should consider how ready they are for change and whether they have the right skills and knowledge to respond to the impending threats. Organizations which are willing and nimble enough make the changes will not only survive but thrive in today's competitive landscape.

Figure 2

The Responses to the Import Threat



This Executive insights outlines techniques for immediate response. In subsequent Executive Insights, we will discuss structural solutions to the longer term challenge, fundamental business model redesign, and new organizational partnerships.

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