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Competing During Contractions



You must distinguish yourself – and your product – during tough economic times.

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I've reported on a lot of seemingly negative economic news lately, but it remains unclear whether the current state of affairs meets the economists' definition of a recession (a widespread decline in economic activity lasting more than a few months). But, to take a line from the political world, all economics is local.

For example, there are a few economic pundits who proclaim that we are already in a recession. Others counter with their own set of data and statistics to the contrary. Earlier this summer, I reported on my "Making Cents of Green Industry Economics" blog,

<http://ellisonchair.blogspot.com>, the following economic news:

- Real gross domestic product growth has been better than expected (good).
- Real personal disposable income grew at the highest rate in months in April (good).
- Consumer confidence dropped for a fourth straight month to 59.8, the lowest since 1980 (bad).
- Unemployment is only running at 5 percent, while interest rates are quite low (good).
- One-year inflation expectations grew to 5.2 percent (bad).
- Falling housing prices continue to be a significant source of downside risk to the economy (bad).

Talk about a good news, bad news scenario. But one thing is for sure – some states (even entire regions) have most certainly experienced a period of contraction. This has been far from uniform, though, with a dozen or so states experiencing severe contraction, while others have

to 8 percent. Speak when others are quiet, and even a whisper can be heard. Imagine if you shout.

Another thing growers should consider (and this will either seem intuitively obvious to you or sound ridiculous) is to raise their prices incrementally over the next 12 to 18 months. I have some excellent case studies of companies that have recently raised their prices and increased profitability as a result.

I do want to point out, though, that the only way in which this makes sense economically is if the company successfully differentiates itself in the mind of the customer in terms of the types of products or services offered and the segment(s) of customers it targets. It's a well-proven fact that customers use five different attributes in making a decision about what products/services to buy and from whom to buy them — quality, value, service, convenience and selection.

We economists characterize demand by a concept called the "price elasticity of demand," which measures the nature and degree of the relationship between changes in the quantity demanded of a good/service and changes in its price.

Elasticity and total revenue. An important relationship to understand is the one between elasticity and total revenue. The demand for a good/service is considered relatively inelastic when the quantity demanded does not change much with the price change. So when the price is raised, the total revenue of the firm increases; likewise, when prices are lowered, revenue decreases.

What this effectively means is that green industry companies can actually raise their prices, and though they might sell fewer units, total revenue for the company still goes up. So, the obvious question is this: *How does one go about making local demand more inelastic?* The answer: By distinguishing the company somehow in terms of quality, value, service, convenience and selection. That's why your marketing efforts are so important. They are the key to successful differentiation.



If you can distinguish your products and/or services enough from the competition, you should consider raising your prices.

Let me repeat this. *If your company successfully differentiates itself from competitors, you essentially make your company-level demand more inelastic within your respective trade area and can subsequently raise your prices and – even though you may sell fewer units – total company revenue will still increase.*

I can hear the objections already: “If I raise my price, my customers are going to defect and buy from my competitors.” Let me provide my own testimonial regarding this common objection to raising price. Over the past few years, all (100 percent) of the green industry firms that I have convinced (after much prompting and counseling) to actually try this have experienced an increase in total company revenue. Not many, not most ... ALL.

Interestingly, some even found that per-unit sales actually increased when they raised their prices, which tells me they were pricing their products way too low to begin with. Low prices tend to result in a low-quality perception in the mind of the customer, and when you raise your prices, you can sometimes influence the price-quality connotation positively.


Cut-rate competition. In recent years, I’ve had many growers ask, “What do I do when another grower sells product in my market at a price below my break-even cost?” While there is no perfect answer to

this question, I have included the various options below. Some are better than others, depending on the situation.

- -Sharpen your sales skills. For example, educate buyers regarding your unique selling proposition in terms of your quality, value, service, convenience and selection relative to the competitor(s). Also, emphasize the historic “win-win” relationship you have shared with the buyer — assuming you have one, of course. Some examples might include: a) that you have been there when they needed you; b) that you did not gouge them with extraordinary price increases when availability of a certain product in the market was low; and c) that the low prices obtained from the undercutting grower are simply not possible at the quality level you typically provide.
- -Go and buy as much of the competitor’s product you can and use it as part of your own inventory — assuming it’s of comparable quality or could be within a short period of time. Treat it as a prefinished product. Finish it out, and capture the margin.
- -Consider the nature of the product they’re selling in your market. If the product has become “commoditized” — it has become a commodity item that many are starting to grow and carry — then you have the option to quit growing it or grow a different size, form, cultivar or variety. In other words, tweak the commodity so that it becomes a differentiated product. Or let someone else grow the commodity product. You buy it in, turn it, and capture the margin. Don’t spend valuable managerial time selling a commodity.
- -Match the price in the short run. A marginal pricing strategy (where selling price is greater than your variable costs, but less than total costs) can be used in the short run, but remember that it is not sustainable in the long run. With this strategy, you’re attempting to “wait out” the competition until theoretically they go out of business or can no longer afford to compete in your market. This is considered to be more reactive in nature, whereas the first two options are more proactive. Forget about this option. It’s an option, just not a good one.
- -Examine your production system and the associated costs of production for that product. It may be that you are using a system that increases your relative costs of production.

Lean manufacturing and shaving costs off the value chain are important as the industry matures, but if we (as an industry) are to make any *meaningful* increase in our margins and increase profitability, it has to come from the demand side of the equation, which means we must obtain higher prices for the products and services we offer.

So continue to put your best differentiated foot forward, exceed customer expectations and keep spreading the message about: 1) the healthful aspects of fresh flowers, shrubs and trees; 2) the positive ROI



that landscaping adds to curb appeal and home values; and 3) that we are a part of the solution to the stress of economic downturns!

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Photos by Dr. Charles R. Hall

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