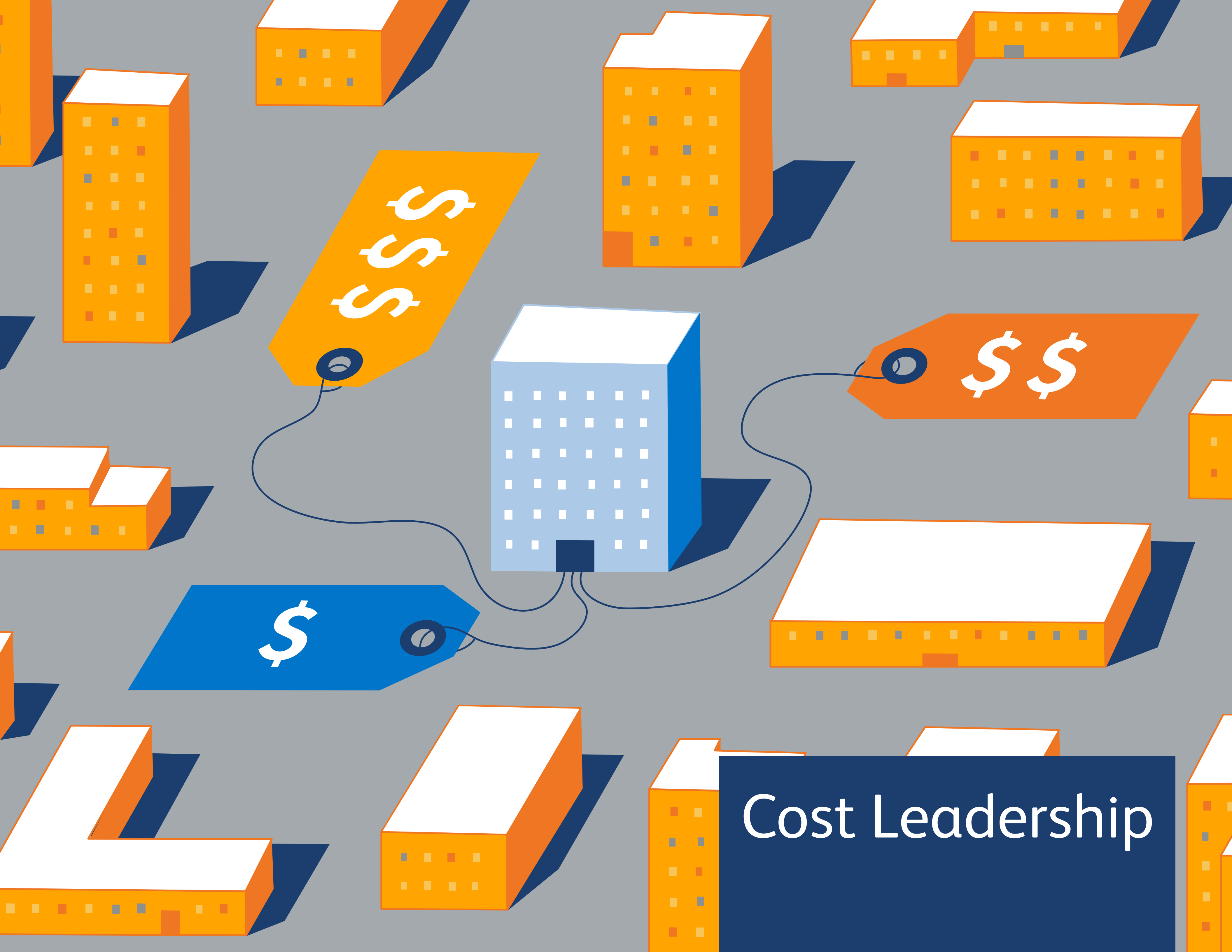


Cost Leadership

5 Ways to Become a Cost Leader

Use this checklist to refine your company's approach to pricing.

Today's executives are cost conscious. In fact, cost leadership is a focus of competitive strategy for nearly 40 percent of midsize businesses.[1] Companies are making it a strategic priority for good reason: It's one of the widely cited "generic strategies" coined by Harvard Business School Professor Michael Porter.[2]

According to Porter, cost leadership is one of three main ways a company can shape its competitive strategy, and it boils down to having the lowest per-unit cost at a given level of quality. No two strategies are identical, but here are a few essential ideas to keep in mind, so you can set your business apart from the rest:

1

Ensure access to growth capital and efficient working capital

Having the continued ability to invest in your production assets creates a barrier to entry, keeping competitors from gaining ground.

Example: Cost leader Walmart incurred $13.1 billion in capital expenditure in fiscal year 2014 to expand its retail footprint in the U.S. and internationally.[3]

2

Develop proprietary technology

Investing in new technology may be expensive and result in short-term losses. However, a properly researched investment in technology should lead to expanded market share in the long run. Institute an R&D program to cultivate new developments and set the stage for future success.

Example: Amazon has disrupted the retail business, in part, by developing or acquiring proprietary technologies such as its Kiva robots, which streamline order fulfillment.[4]

3

Streamline your inputs and improve your relationship with suppliers

Having the best access to supplies is essential to competing on cost. Conduct financial modeling of your raw material inputs—incorporating risk analysis, projections and cost tracking—to more adequately forecast ROI and identify areas for consolidation.

Example: Seabridge Gold secured access to the world's largest undeveloped gold and copper mine in British Columbia and Canada, which has an estimated life span of more than 50 years.[5]

Facing a Low-cost Competitor?

It's a familiar story, one replicated in industry after industry. After years of dominance, a market leader is shaken to its core by a low-cost rival. What comes next is the interesting part. Researchers have found that companies tend to respond in one of several ways:

- They ignore the upstart, which often forces the former market leader to vacate an entire market segment
- They respond to the pricing challenge, which often ignites a price war
- They experiment with a dual strategy by launching a low-cost product of their own
- They differentiate their offerings

The bottom line? There's room for both low-cost and value-added companies. The important thing is for businesses to stay on the offensive. As Nirmalya Kumar of the London Business School wrote in the Harvard Business Review: "If incumbents don't take on low-cost rivals quickly and effectively, they can blame no one for their failure but themselves."

4

Closely monitor labor costs

Supervising your workforce to ensure it is maximizing its time is critical. Consider using tracking software to see how your staff members are spending their work hours, or invest in scheduling software to staff the right number of people at peak times of day.

Example: Trucking company Schneider National uses tracking software to monitor drivers' safety and performance on the road.[6]

5

Re-evaluate your production and administrative costs

Controlling costs by ensuring you have a streamlined organizational structure and small corporate staff will keep your business operations as lean as possible. Consider outsourcing any functions you don't need to cover in-house.

Example: In order to reduce its general costs and improve margins, data storage company Quantum outsourced its sales and marketing divisions to an outside company, which saves both time and money.[7]

[1] SunTrust Quarterly Nationwide Survey; [2] "What Is Strategy?" November/December 1996, Harvard Business Review; [3] "Analyzing Walmart—The World's Largest Retailer," Feb. 18, 2015, Market Realist; [4] "Kiva Systems officially rebrands as Amazon Robotics," May 20, 2015, DC Velocity ; [5] "Canada approves world's largest copper-gold project," Dec. 19, 2014, MINING.com; [6] "Memo to Workers: The Boss Is Watching," Oct. 22, 2013, The Wall Street Journal ; [7] "Witness How Quantum Corp. Improved Their Sales Process Through Outsourcing," Feb. 6, 2015, Invenio Solutions

Southwest Airlines
Earns Loyalty with Low Prices

In the age of the a la carte airline upgrade, Southwest has taken a different approach to become a cost leader and customer favorite.

THE COMPANY

Southwest Airlines Co. began modestly in 1971 as a Texas-based operation serving Dallas, Houston and San Antonio. Today, thanks to its ability to achieve rapid expansion through a model of lean operations and low overhead costs, the company serves 94 cities in seven countries.

THE CHALLENGE

Earning a profit in the airline industry has never been a given. In fact, the industry's average per-customer profit is only $8.27.[1] Cost-cutting strategies, such as reducing leg and head-room to allow for additional seats, may make room for extra revenue, but they often decrease customer satisfaction in the process.

THE SOLUTION

To achieve cost leadership, Southwest targets efficiency. The company uses only Boeing 737s in its fleet rather than a variety of aircraft, which reduces the training needed for pilots, crews and mechanics.[2] It also forgoes seat assignments, eliminating the time and cost of reissuing new boarding passes in the event of a last-minute aircraft switch. Open seating contributes to a faster boarding process, which in turn allows Southwest to turn around flights in an average of 25 minutes, compared to 40 for other airlines.[3] Quicker turns mean less time on the tarmac, more flights and happier customers.

Southwest also adheres to a "bags fly free" policy for checked luggage, which, in addition to earning customer appreciation, saves time during boarding since customers aren't trying to carry on oversized bags. And, unlike many of its competitors, Southwest flights follow a point-to-point system so that planes fly from departure city to destination, turn around and repeat rather than funneling through hubs where the volume of air traffic can lead to delays.

By keeping operations simple and lean, Southwest achieves cost and time savings that can be passed along to its customers in the form of low fares and high satisfaction. In fact, the American Customer Satisfaction Index shows Southwest leading the industry for 16 of the last 20 years.[4]

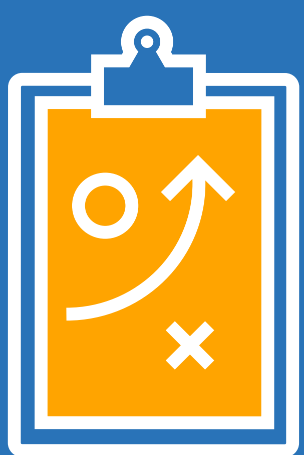
The lesson? Cost leadership, when used strategically, can be the key to out-pricing the competition and growing a satisfied and loyal customer base for your business.

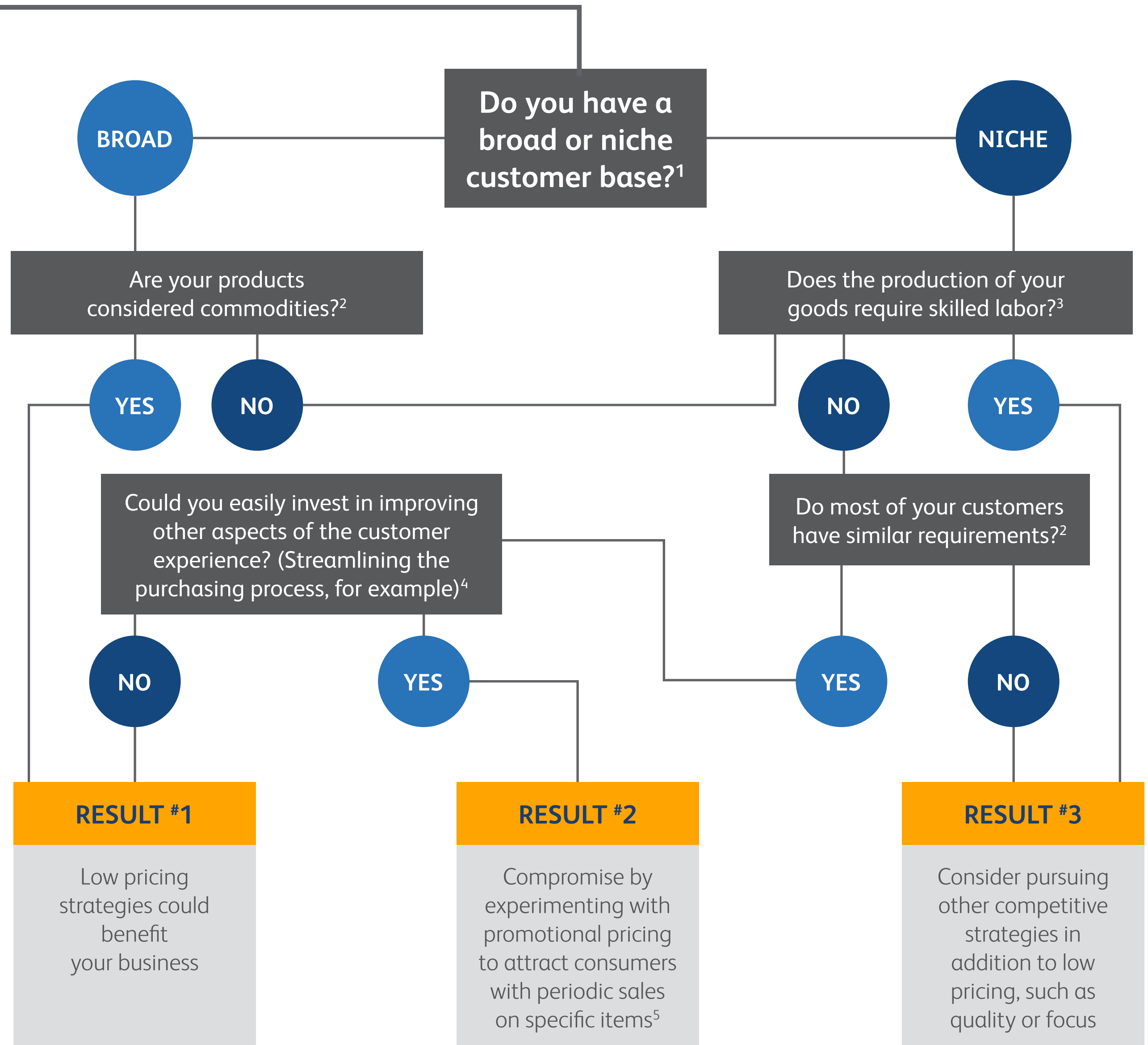
> **"The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines."**
> —Warren Buffett in a 2008 letter to investors

[1] "Airlines Aren't Making Nearly As Much Money As You Think," June 10, 2015, Time Money; [2] "The Southwest Secret," June 12, 2012, Slate; [3] "Lean, Not Mean—3 Reasons Why Southwest Wins with a Culture that Empowers Employees," Feb. 19, 2013, CustomerThink Corp.; [4] American Customer Satisfaction Index Benchmarks by Industry, Airlines

Is **Low Pricing** the Right Tactic for Your Strategy?

Before you decide to undercut your competition, ask yourself the following questions to determine whether low pricing is the best strategy for your business.





[1] *"Cost Leadership," Saylor Academy;* [2] *"Competitive Strategy," California State University, Sacramento;* [3] *"Examples of Cost Leadership & Strategy Marketing," July 13, 2011, The Houston Chronicle's Small Business;* [4] *"Should I Lower My Prices to Compete?" July 2015, ConversionXL;* [5] *"Everyday Low Pricing May Not Be the Best Strategy for Supermarkets," Dec. 17, 2011, Stanford Graduate School of Business*