LOW-COST STRATEGIES IN THE CONTEXT OF GLOBAL MARKET DYNAMICS

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Abstract

The globalization process has generated an increase of the international competition, fact that influenced the strategies adopted by the firms. As a consequence, the multinational companies, looking for competitive advantages, decided to locate their production in less developed or developing countries, with low costs of labor force and raw materials. The purpose of this article is not only to analyze the impact that the relocation of production has on the macroeconomic level, but also to determine the consumers' perceptions and their responses to the challenges generated by this process.

Key words: low-cost strategies, globalization, relocation, competition, competitive advantage

1 Introduction

A surge in the activity of multinationals in the developing world has opened a new chapter of globalization. What once was a marginal activity in the emerging markets, now it has become essential for the competitiveness and growth of many foreign companies. From this point of view we can note that, if in a broad sense the competition between systems ended with the victory of capitalism against communism, in a narrower one, this competition is just beginning [Sinn, 2004, 23-38]. The idea can be supported by the fact that more and more firms are transferring their operations to countries with low wages and taxes in order to cope with the increasingly intensive international cost competition. The relocation of production is characteristic to firms that act in various fields, from rubber industry, metallurgic or auto industry, to food and beverage one, electronic and electrotechnical industry, clothes industry or even to the banking sector. We refer to companies such as US Steel, Goodyear, United Brands, Phillip-Morris, General Motors, Nike, Budweiser, Exxon, Motorola, IBM, Siemens-Nixdorf, Deutche Bank, Volkswagen, Toyota, Citroen or Peugeot.

The more liberal the trade relations are, the easier the relocation becomes. Nowadays, the global commercial system is characterized by intensive commercial networks, that involve almost all the economies, and by the presence of some global markets for products and services. As a consequence, the small and medium firms have to cope with the direct competition of the multinational corporations that enter their home countries.

The following chapters show not only the effects generated by the relocation of production on the macroeconomic level in the developing countries, host for the multinationals' subsidiaries, but also the impact that this process has on the microeconomic level, on the consumers' decisions to purchase various goods.

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2 The macroeconomic effects of the relocation of production

Trying to determine the effects of the relocation of production, we can argue that the production costs of the multinationals become lower and lower, after entering the emerging markets [Farrell, 2004, 1-7]. The explanation is that the investors are improving the efficiency and the productivity of the activity's sectors through the allocation of financial capital, new technology and modern managerial structures, determining national companies either to improve their quality or to quit the activity. So, these low-cost goods will be exported at a price lower than the market's global medium one, for those products.

Analyzed in a larger context, the multinational firms seem to affect the international trade structure, by relocating their production in less developed countries [Ross Yeaple, 2005, 429-448]. This idea is particularized by B. Eichengreen and H. Tong on the case of China [Eichengreen, 2005[a]]. They note that the foreign investors will be tempted to invest in this country with low-costs of labor force, affecting the ability of OECD countries to attract FDI. So, it is arguable that, currently, China is one of the most important forces that reshaps the world economy [Eichengreen, 2005[b], 73-97]. Next to this country, lately, the Central and Eastern European states, members of the European Union, have become favorite destinations for the multinationals' production subsidiaries. They attract the investors because they have some advantages: they are European Union members, so they are considered to have stable economies; their governments are providing incentives ranging from investment to low taxes on employee wages and corporate profits (for example, in Slovakia all the taxes are 19%); many of them have a good infrastructure and the access from these countries to other European clients is easy; they have a low cost of labor force; and, last but not least, these states show a long term profitability. Referring to the low cost of labor force, the manager of the Peugeot company, from Slovakia, argues that there the engineers earn only half of the wage of a Western engineer, and the assembly line workers have only a third or even a fifth of the salary they could have earned in a Western country, for a similar job [Tagliabue, 2006, 1-3].

V. A. Gallagher has a different opinion from those mentioned above, considering that low prices are an advantage for the first-world consumers, with high incomes, and the poor have to face an even greater risk. As transnational corporations try to increase profits by reducing costs, the employees of these companies - living in the less developed or developing countries in which the production subsidiaries are -, work long hours but are still poor and subject to abuse [Gallagher, 2006, 17-28].

As it can be noted, there are different opinions concerning the winners and the losers of the relocation of production. Yet, one thing is sure: both the developed and developing countries benefit, up to a certain level, from this process. The first ones, home of the head offices, take advantages of the success and of the profit of the multinational firms. In the case of the developing countries, it is possible that, once the multinationals enter, the unemployment rate decreases, the foreign investments rise, the health conditions get well, the infrastructure improves, the living rate increases and the opportunities for education and training diversify. Despite all these advantages, we do not have to neglect the fact that there are also some difficulties that have to face especially the developing countries. We can mention here the fact that, although the incomes are much smaller in these states than in the developed world, the retail prices of the essential consumer goods are not appreciably lower than in the USA or Western Europe. Moreover, it was shown that, due to deregulation and free trade, the cost of living in many developing countries is now higher than in the United States [Chossudovsky, 2003, 31]. A possible explanation of this situation is to be found in the fact that, practicing competitive prices when entering the emergent markets, the multinationals increase the vulnerability of the medium native companies. As a consequence on long term, a strong polarization of profitability will take place within and among sectors, while the prices will continue to rise.

3 The influence of the low-cost strategies on the multinationals' activities

The method of cost reduction, which focuses on obtaining a competitive price, is known, in the literature, as the strategy of low-price or penetration price. It represented the subject of many national and international approaches. On the national level, V. Danciu is one of those who have analyzed the cases when this strategy can be successfully applied. He considers that a low price is advisable when: the demand depends on price and it could be obtained a higher level of the sales in the stage of market penetration; once the level of sales has raised, it is possible to gain financial advantages; the competition is harsh even from the stage of market penetration; the low price discourages the potential competition; the absorption power of the market does not allow a high price. If these conditions are fulfilled, then such a strategy can be very profitable, on long term [Danciu, 2001, 348].

An important aspect regarding the price strategies, which is also relevant for low-cost products, is the diversified price strategy [Kotler, 2002, 696-698]. Due to deregulation of many sectors, the competitors started to use more and more diversified tariffs. A good example for this is represented by the airline companies that have different prices for the tickets of the same charter, depending on the type of flight class, the time period of the flight, the day of the week, season, on the firm that pays the ticket or on the frequency of using, in the past, the company's services. Airlines companies are implementing the tariffs of revaluation in order to gain a higher profit. The new aspect regarding diversified price strategy, mentioned by Ph. Kotler, with particular importance for low-cost products and services, is the digital diversification [Kotler, 2002, 699-703]. The Internet reestablishes the principles of price setting, both for sellers and for consumers. The sellers can keep an eye on customers' behavior and adapt their offers at an individual level, have special prices for some of them, much lower than the usual ones, and they can even change the prices, depending on the demand. In the same time, the customers can take the advantage of the fact that they can establish a determined price and get an offer for it.

Analyzing the advantages brought by the Internet transactions, J. Bughin noted that many banks, due to their high costs, started to transfer a larger proportion of their customer base to the on-line operations [Bughin, 2001[a], 1-19]. One of his conclusions is that the banks, pursuing a global cost-effectiveness strategy to differentiate them versus the competition, will likely be the ones which have been pushing the on-line channel faster than the others [Bughin, 2001[b], 11-15]. This cost reduction method was implemented even by the banks which initially had lower costs, in this way obtaining a higher competitive advantage.

Ph Kotler notes that, gradually, many companies that start their business on Internet will follow the business trend of Priceline [Kotler, 2002, 699]. This site (Priceline.com) allows customers buy the last-minute airplane tickets even fourth time cheaper than the normal price. So, the benefits are both for the customers and for the airline companies, which could complete the free seats.

G. Francisc, I. Humphreys, S. Ison and M. Aicken foresee an increase of low-cost airlines, in the next years [Francisc, 2006, 83-94]. Meanwhile, they consider that the airline companies will start looking for other ways to differentiate their activity, following the example given by AirTran, Frontier, JetBlue or EasyJet. From all these companies, JetBlue was the one that has changed the low-cost airlines model, which was purely price-driven. The consumers have embraced JetBlue's services not only because it is cheap, but also because it is better. While the most part of low-cost companies have become ineffective because they tried to fight only on price, JetBlue is competing on value. This strategy is an implementation of M. Landsbaum's opinions about the importance of analyzing the customers' needs. Considering these needs, low-cost firms should try to satisfy them as much as possible [Landsbaum, 2004, 125].

4 The price influence on consumers' behavior

In order to determine the consumers' perception of price, it is necessary to analyze their price sensitiveness and the way in which the relation price-quality influences them.

D. Asch and B. Wolfe argue that the growing importance of a product's quality depends on two factors. The first one is the national income: as nations prosper, consumers wish to buy not just a greater quantity of goods and services but also higher quality products. The other factor is the liberalization of world trade: in the context of the economic globalization, the suppliers from the developed countries increasingly face the competition of those located in low-wage countries [Asch, 2001, 30-33]. Consequently, many firms from the developed world are repositioning them to produce relatively sophisticated products that embody highly skilled labor or cutting-edge technologies, factors of production in which the developed countries still enjoy a comparative advantage to the developing world. Consequently, the product quality becomes increasingly important for firms located in developed economies. It is known that, for example, a large number of the French people would prefer a brand product, more expensive, with a guaranteed quality, than a cheaper one, with a no-name brand. Moreover, the geographic indications, which state the origin of the product, offer an added value and also a higher price. Despite this, it was noted that 40% of the French consumers are able to pay up to 10% more for a product with a guaranteed origin [EC, 2003].

Considering only the consumers' perception of price, we can agree that, generally speaking, the clients analyze the prices according to their own reference ones. These are extern reference prices – influenced by the environment, or intern ones – prices that already exist in the subjective memory of consumers [Zollinger, 1995, 89-101]. As a consequence, the customer sees the price of a good as an image of its quality and value. So, establishing a price under the level that the customer is ready to pay for a product means to destroy its market value. This involves that the low prices have to face some risks: the low quality trap – when the consumers will see the price as an index of the quality, the fragile market share trap – the low prices can raise the market share but not the faithfulness of the clients and the trap of small pockets - the low price may not always increase the sales [Dumitru, 2002, 121]. Consequently, a strategy focused only on the price reduction, ignoring the impact on the consumers' behavior, may not always have favorable results.

5 Conclusions

The relocation of production is an ever growing process, fostered by the liberalization and by the intensification of the trade relations between states. Despite some unfavorable consequences of this process, we can argue that the positive effects are prevailing both for the developed countries and for the developing ones. The multinationals generate many opportunities that may foster the economic growth of the developing countries (such as the reduction of the unemployment rate, the rise of the foreign investments, the improvement of education and health conditions, etc).

The profit of the multinational companies follows an ascending trend, so, in the future, it is possible that they increase and diversify the operations. Yet, they do not have to neglect the consumers' behavior toward the consequences generated by the relocation of production. It is obvious that, in most of the developed countries, the consumers put a great accent on the quality of the products they buy. Consequently, we may conclude that both the price and the quality are central factors in establishing the firms' objectives and strategies, vital aspects in a competitive world.

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