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WELCOME TO COMMODITY HELL: THE PERILS OF THE COPYCAT ECONOMY

Faster, Bigger, Harder

“Either you innovate or you’re in commodity hell. If you do what everybody else does, you have a low-margin business. That’s not where we want to be.”

Sam Palmisano, CEO of IBM, uttered those words, and Robert Winqvist would painfully agree. Winqvist is CEO of Vending Supply, Inc. (VSi), one of the premier designers, manufacturers, and distributors of children’s stickers and temporary tattoos. When your kids insert quarters to buy stickers or tattoos in vending machines at grocery stores or malls, they’re probably buying a VSi product. Within two years of its launch in 1993, VSi was the fastest-growing, coolest player in what’s known as the “flat vending industry.” Before VSi, the industry was stagnant, dominated by big players churning out high-volume, look-alike stickers with conventional, bland images such as flowers, fairies, and smiling fish. VSi changed all that. Winqvist and his partner, Sherry Backman, found edgy artists to create high-octane images such as smiling death heads, space aliens, and skateboard heroes. They pioneered the concept of third-party licensing for stickers, partnering with the World Wrestling Federation to create images

of posturing wrestling celebrities. They also ran their business in unconventional ways: They hung out with 8- to 12-year-old kids to determine what was cool, they worked closely with the organizations that actually placed and operated the vending machines, they segmented their markets into Anglo and Latino, and they embraced the newest manufacturing technologies for speed and execution efficiencies. To entrenched players in the industry, their efforts were the work of arrogant and unwanted nut cases.

VSi's customers were thrilled. "We brought stickers to the forefront of cool," said Winquist, and the vending machine owners agreed, gladly paying VSi a premium to please the lucrative "tween" demographic. VSi grabbed margins and market share, while Winquist continued unleashing wicked designs. For eight years, VSi grew at a 30 percent rate, becoming one of the largest four players in the field. Every year, it improved its design, distribution, cost-efficiencies, and service. Much larger companies went bankrupt during that time. Pricing was not a big issue. Margins were big. Salaries were high. Life was good.

Then, says Winquist, "Our business began to fall. The decline was not in our volume; it was coming right from our bottom line. The reason is that everyone now is doing cool art. Everyone's hiring cool artists. Everyone's stickers and tattoos are so good that we all look pretty much the same. Stickers used to be a commodity before we came along. They are now a commodity again, but at a new level. The industry is glutted with cool product. Customers take it for granted."

VSi had to start competing on price. Because all the major players had copycatted VSi and were printing, outsourcing, and distributing more efficiently, there was little room to squeeze out more costs. In 2004, Winquist told me, "Today VSi is three times more creative and three times more efficient than we were ten years ago. That means we're nine times better. But our margins are one fifth what they used to be three years ago. *What's going on?*"

Welcome to Commodity Hell, Mr. Winquist. Or more accurately, welcome to the Copycat Economy, where everyone has access to the same resources and talent, where the Web is the great equalizer, and where the market's twin foundations are imitation and commoditization. It's a world marked by the "me-too" syndrome, where competing vendors benchmark, imitate, and build off each other, offering customers an ever-increasing array of choices, most of which look pretty much the same. VSi had exploded from the pack because its

products, services, and processes were so outrageous that the company puzzled, angered, and intrigued competitors while exciting the hell out of the customer base. As Winqvist explains, VSi's edge—and success—came about “because we violated a lot of industry rules.”

But after several years of glory, the pack suddenly caught up. Within a two-year period, the edge that VSi had created, cultivated, and benefited from all but disappeared. Later in this book, I'll tell you what has happened to VSi, but for now I want to discuss the forces that pulled the company back into the pack.

First of all, keep in mind that it's not only stickers—or, for that matter, PCs and dishwashers and insurance policies and designer coffee—that become commodities. Every organization faces the challenge. IBM is discovering that even its traditional discrete consulting services are slowly becoming commoditized, a term IBM itself uses. Companies like Wipro—based in Bangalore, India—are replicating some of IBM's consultative offerings at much lower prices, which is why, to IBM's chagrin, companies like Louis Vuitton and Target are turning to Wipro for basic information technology and data-management expertise.

When I consulted at a major mutual fund a few years ago, I was told at the first meeting, “Oren, the first thing you have to know is that mutual funds are commodities.” The company vice president said, “There are thousands of mutual funds that compete directly against ours, and over the long haul we pretty much have the same yields and performance, so our main job is to figure out how to differentiate ourselves so that investors will choose our products.”

Twenty years ago, not many people even knew what mutual funds were, much less invested in them. Now millions of investors choose from more than 10,000 funds—a bigger number than the number of actual stocks traded on the New York Stock Exchange and Nasdaq combined. Small investors can pick one off as if they were shopping at Wal-Mart because mutual funds have become just another financial option with discounts and no-load fees. The same is true for hedge funds. Once they were instruments exclusive to those who could plunk down a couple million bucks and wait things out. Now every financial institution is offering its discount brands of McHedge funds to attract the masses of people who want to feel like they're special, too. Thus a once-special product line begins to lose its distinctiveness and vitality.

Two principles keep companies trapped in the pack and snared in the Copycat Economy, and make up the most challenging double whammy affecting your organization's competitiveness and very survival:

1. *The inevitability of perpetual imitation*
2. *The commoditization of everything*

These twin scourges are affecting every business at an accelerating pace. Old competitors find it easier to quickly imitate market leaders; new competitors find it easier to improve on them. Customers can choose among a glut of vendors who are basically offering similar products, quality, and services. “Buzz,” prices, margins, and customer loyalty begin to drop as consumers shop around for the best deals. Some vendors might be “better” than others, but not enough to matter when the others are all “good enough.”

Ultimately, customers—and investors, too—wind up concluding that the pack of fiercely warring competitors is bound by the same conventional approach. What happens then is fairly predictable. When customers see little difference in the availability and perceived quality of goods and services, they have a rational response: They buy what’s cheapest.

When companies no longer can maintain their competitive edge, bad things start to happen over and above falling financials. Vital corporate intangibles like excitement, joy, and optimism begin to falter. Coming to work becomes less of an adventure, more of a grind. Attracting top talent becomes more difficult; in fact, the best and brightest on board begin to polish their resumes (always a good indicator of organizational decline). And companies make stupid, reflexive choices, like slashing any costs possible to make this quarter’s numbers, or throwing budget, carrots, and whips at the sales and marketing people to jack up revenues—all compulsions that are meant to push them forward but actually mire them among their competitors, who are doing the same things. Dealing with other players in the value chain becomes less a creative, collaborative, value-creating process and more of an uphill battle focusing primarily on commodity discussions of price, specs, and contracts. All this happened to VSi, leading Winquist to sigh, “It’s not fun like it used to be.” Such are the traps of commoditization and imitation.

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