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Authors: Engardio, Pete
Keenan, Faith
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The Copycat Economy

ECONOMY: 7 Once, a hot new idea spelled years of fat profits. But these days, rivals are moving into markets before you can say "clone"

Scenes from the corporate battlefield:

- For a decade, the refrigerator-size Symmetrix unit was the Goliath of the data-storage industry. Costing up to $3 million, it enabled its maker, EMC Corp., to reap fat profit margins. Then, in 2001, IBM and Hitachi Data Systems launched similar boxes. Prices plunged 60% last year, and are down about 35% this year.
- Kyocera Corp.'s QCP 6035 Smartphone, a combination personal digital assistant and Web-ready phone priced at $500, looked like a winner when it appeared in early 2001 — until Samsung Electronics Co. launched a smaller PDA-phone with a color screen months later. The Smartphone now retails for $150.
- Last fall, Procter & Gamble Co. thought its $50 Swiffer WetJet mop, which sprays water on floors, would be the killer app of housecleaning. But then Clorox Co.'s ReadyMop forced P&G to cut its price by half in seven months.

Competition is the essence of a market economy. But rarely has it been this brutal. In numerous industries, companies are finding it increasingly hard to maintain a unique advantage long enough to make good profits on an innovation. Time was, companies could milk a novel product for years before cut-rate clones arrived. Now, new TVs, packaged foods, telecom routers, e-commerce concepts, and wireless services are barely out the door before rivals are on their tails, bludgeoning prices.

Call it the copycat economy. And it raises some critical questions: How do you make money in such an environment, especially when demand is flat? Already, the lack of pricing power partly explains why productivity gains of 3% to 4% aren't always translating into higher corporate profits. Longer term, it suggests companies may find it harder to sustain strong growth.

Many factors are at work. In pharmaceuticals, where drugmakers are hyping derivatives of old blockbusters like Claritin as their patents expire and generics swarm in, there's a paucity of technology breakthroughs. In electronics, digitization makes hardware easier to copy, since change is propelled by constant semiconductor and software advances. There has been an explosion of low-cost Asian rivals. And the rise of contract manufacturing and design has lowered the entry barrier for new players who lack factories and big labs. As a result, says CEO Michael E. Marks of contract manufacturer Flextronics Corp., keeping a product from becoming a commodity "will just get harder and harder."

Even many innovative productivity-boosting strategies of the '90s are commonplace. Nearly everyone now boasts of near-zero-defect quality, efficient supply chains, and virtual design. Often, they use the same contractors, consultants, and software. The shift of business to the Net also quickens the spread of management processes. "Everyone has the same capabilities," says Allen J. Delattre, head of Accenture Ltd.'s supply-chain consulting practice for electronics. "Even speed and quality are commodities."

For consumers and the U.S. economy, this dog-eat-dog battle is terrific. The rapid dissemination of innovation has helped spur America's productivity gains. It also means lower prices and greater choice. When color TV appeared in 1956, it took two decades before the price dropped in half. It took a decade for VCR prices to halve. In contrast, prices for DVD players, launched in 1997 for $700, halved in about two years, and now they sell for $153 on average, says market researcher NPDTechworld. Deflation has accelerated in other sectors. Since 1997, retail prices for women's apparel are down 8% on average, reports the Bureau of Labor Statistics. Television prices are down 30% in the U.S.; monthly cell-phone service, 32%.

For companies, though, benefits can be fleeting. A Mercer Management Consulting Inc. study suggests tech leaders are flaming out at a faster rate. In the 1980s, five years lapsed from the time the stocks of Digital Equipment, Wang Labs, Control Data Systems, and other highfliers went from 50% of their peak value, hit their highs, then dropped again by 50%. By then, rivals had saturated their markets or offered better technologies. In the early '90s, Cray, Sybase, and Lotus blasted off and fell in four years. In the late '90s, Lucent, Palm, Cisco Systems, Novell, and others peaked and stumbled in less than three. Their revenues followed similar curves. Mercer's Richard Wise thinks the shrinking half-life of tech leaders points to a critical issue. "A lot of companies are hitting a growth and value-creation wall," Wise says. Less tolerance for accounting tricks exacerbates the task.

Some companies are special. Dell Computer and Wal-Mart Stores are so good at execution that they always seem to be two steps ahead of the pack. Some winners control an industry standard, like Microsoft's Windows operating system. But it's getting harder for companies to establish such standards, Wise notes. Customers and rivals have ganged up to keep Nokia, America Online, Gemstar, and others from becoming the Microsofts of their industries.

There are ways to avoid the trap. For example, more companies view their hardware as platforms for pushing upgrades, spare parts, and software. That's how General Electric Co. and Sony Corp. make most of their money on aircraft engines and game players. EMC hopes software and services for banks, airlines, and others using its data-storage gear will drive future profits. Other companies constantly pump out cutting-edge products that fetch premium prices, however fleeting. To succeed in this game, companies often must get costs down to mass-production levels as soon as a new product hits the market — rather than months later. "Otherwise, you'll never make money," says Dellatre. That's one reason behind Samsung's success in new cell phones.

Another gambit is to tweak existing formulas and designs constantly. Thus, Colgate markets some 10 variations of toothpaste. Spanish clothing company Zara takes this to the extreme. It can modify a garment sold in its retail stores in two weeks, based on customer feedback from salespeople taking notes on handheld PCs.

Some companies are doing the opposite. They focus their research on fewer products, tenaciously defend patents, and back well-established brands with heavy marketing. A $500 million annual ad budget helps Gillette Co. charge $30 for its new Mach3Turbo razor and 12 replacement cartridges — while disposable razors go for $3.29 a dozen. As part of its goal to double profit margins in five years, Unilever Group has whittled its brands from 1,600 to 400. "It is increasingly difficult to develop consumer products that are truly breakthroughs," says Randy Quinn, senior vice-president for brand development. Instead, Unilever slaps its best brands on more products. Dove now appears on shower gel, deodorant, and skin cleanser.

But how long can such strategies produce growth? And as imitators try the same tactics, who is generating new demand? Or is everyone just cannibalizing each other? Eventually, companies must intensify the search for technology breakthroughs and new business models that deliver sustainable advantages. Until then, it will be hard to escape the copycat jungle.

Remember DEC and Wang? They lingered at the top of the tech world compared with today's flameouts

PHOTO (COLOR)

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By Pete Engardio and Faith Keenan
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