Competition for the Consumer

This essay was originally published in Muhlenkamp Memorandum *Issue 44, October 1997. During much of the 1990s, companies focused on getting their costs down "to be competitive." Government discussed privatization to lower its spending. The media focus was on the detrimental effects of such actions to the employees. Ron wrote this essay to show the other side of the issue: the benefits to the consumer.*

We often hear the argument that a company or a country must do certain things "to compete" or "to be competitive." This goal "to be competitive" is stated as the rationale for much of the cost cutting and downsizing in industry, as well as the privatizing of various tasks previously done by government, both in the United States and in other countries. We agree that each of these entities should "be competitive," but we think that much understanding has been lost because the sentence is seldom finished. The complete sentence would state: "We must take these steps to be competitive for the consumer's business." Such a statement makes it explicit that the ultimate beneficiary, and the ultimate driver, of these corporate actions is the consumer. In a free economy, the consumer is KING!

In a free economy, no person or company can make the consumer purchase its product; only government can do that. Producers can advertise, pitch, cajole, and sweet talk, but they cannot force the consumer to purchase their product. Unless the producer offers a product the consumer wants, at a price the consumer is willing to pay, no purchase will take place.

Certainly, there are products the consumer must buy—food, clothing, and shelter—but in a free economy there is no requirement to buy these products from any one provider. As long as the market is open, multiple producers will compete for the consumer's business. Over time, most producers learn that the best sales gimmick is to provide a quality product at a cheaper price.

Years ago, I was taught that there are "natural monopolies" for some goods, but I no longer believe that. The only monopolies I can find are government sanctioned. In the current decade, we have opened up markets in natural gas and long-distance phone service and are currently opening electric power. Each of these markets was once viewed as a "natural monopoly." Granted, transitions to freer markets can be confusing. The recent move to deregulate telephone and electric service in the United

States has resulted in some confusion and complaints because people are now asked to make choices they didn't previously have to make. I am told that some people in Russia have similar complaints now that they have choices in buying food and clothing.

The beauty of a free market is that consumers who don't want to spend their time shopping to save the last nickel still benefit from the actions of their neighbors who do. This competition for the consumer's business drives all producers to produce better products at lower prices. I must admit that I didn't understand much of the above until I read Sam Walton's autobiography. Sam Walton founded Wal-Mart. He perceived his job as that of a purchasing agent for his customers. There is nothing you can buy at Wal-Mart that you can't buy somewhere else. The only thing that Wal-Mart claims (or advertises) is lower prices. The sole task Sam set for himself was to bring existing products to his customers at a lower price. He did it well enough to become the richest man in the country.

As an investment manager, I am embarrassed to admit that I never bought a share of Wal-Mart. My rationale was that retailing is the world's second oldest profession; what can Sam Walton do that Kmart can't copy in six weeks or Sears copy in six months? It wasn't until I read Sam's book that I learned that Sam had worked for, and run a franchise store for, a discount retailer. He left because he thought his ideas for lowering costs and prices had merit, but the franchisor wasn't interested in his ideas. And Kmart chose to fight his ideas rather than co-opt them. (Remember that Kmart was the leading discount retailer at the time. Sam Walton and his ideas eclipsed Kmart in 20 years.)

In a free market, the consumer is king. If you serve the consumer by providing a product or service that he or she values, you can get rich. But of equal importance, you can get rich *only* by providing a product that the consumer values. Many is the inventor who created a new product he thought was great, but the consumer wasn't interested. Many is the engineer who improved an existing product (by his standard) only to be chagrined when the consumer didn't appreciate the improvement.

Several years ago, Intel launched a consumer advertising campaign identifying those computers with Intel Inside. But when their next new chip, the Pentium, was found to have an arcane flaw, Intel found consumer awareness to be a two-edged sword. Intel found that statistical analyses and other explanations, which had been acceptable to their corporate and engineering customers, were not acceptable to the retail consumer. The retail consumer was a more demanding customer than the professionals! Intel's management finally realized that, if they wanted to sell consumer products, they had to accept the consumer's standard for performance. Andy Grove, the chairman of Intel, describes this realization as a major "inflection point" for his company. I would describe it as the realization that the consumer sets the rules.

In a free market, every improvement in quality or service becomes the new standard that all competitors are expected to meet. Similarly, each price decline becomes the new standard of competition for the consumer's business.