

Changes in the Company effect of Commoditization

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Abstract

The issue of commoditization has been receiving more attention in recent times. First the debate is now about how quickly commoditization is sweeping across the corporate world; in sectors and functions which we had previously thought were safe from it. And second, it is the depth and breadth to which commoditization is now penetrating; no longer the preserve of the blue collar worker it is beginning to spread into white collar work that is usually considered immune to the negative impacts of commoditization, particularly as it requires the application of intellect, skill and expertise which unlike blue collar work is generally harder to automate. Like so many processes that play out in the business world, it may have started quite slowly and in quite limited areas, but it is speeding up and extending its reach.

Keywords: Commoditization, Competition, off shoring, Skills

1. Shifting gear

Commoditization is no longer just about machinery, computers and plant. Nor is it about the odd industry or two. It is beginning to be about people, human capital, skills and expertise and it is spreading into those industries that have previously held up their margins and kept out the competition. Two obvious and quite simple examples spring to mind, the first is project management and the second is software development and maintenance.

A decade ago, being a project manager was special; there was some kudos attached to the title, as the skills, knowledge and expertise were quite limited and restricted to a relatively few specialists. Project managers could earn decent salaries and could expect to do so well into the future. But things have changed since then. Project managers, although still critical to the average corporate are more common, cost less, and the kudos attached to the title has diminished considerably. In fact most project managers prefer to be called programme managers these days because of the status that programme managers have over project managers. Why has this happened? There are a few reasons. First the number of qualified project managers has increased significantly – no wonder when the demand for their skills has grown as organizational complexity and the need for effective change has increased. The basics of supply and demand have meant that project managers can now be hired more cheaply than in the past. Second professional bodies, academics and practitioners alike have strived to improve the quality and repeatability of the underlying processes of project management, thereby opening them up to the forces of commoditization. The introduction of detailed standards, processes and a proliferation of courses which train people to the same level all help to demystify the art of project management and lower the bar to entry. In essence it has allowed much of the tacit knowledge of experienced project managers to be distilled and codified so that it can become explicit and reusable. Finally, the increasing use of technology, aided and abetted by this codification, has reduced some of the toil and intellectual horse power required to execute the project management processes. Some argue that it releases the project manager to do more value-added work and concentrate on leadership and direction. Others believe

that it has dumbed down the project manager, or has at least allowed the process of project management to be undertaken by someone who is lesser qualified, more junior and ultimately cheaper to employ.

A similar argument can be applied to software development and maintenance, which has also seen dramatic shifts in the profitability of the industry and the incomes of those employed within it. Back in the 1950s software development and IT in general were in their infancy. The sheer complexity and associated costs of building systems was a major inhibitor to its use. However, as waves of innovation continued to yield major advances in technology, organizations started to harness IT to good effect to the point where it is now ubiquitous and according to some commentators at least, no longer matters. Over the intervening 50-60 years, the process of building and maintaining technology systems has been simplified and codified. And although there are still plenty of problems associated with building complex enterprise-wide applications, there are many examples of packaged based solutions which are capable of addressing the needs of any business. As software systems became more widespread the number of people involved with the profession increased and whilst there were limited or no standards in place, those who were in software could command high salaries, especially if they happened to have knowledge of the latest technology, software language or operating system. Over time as standards were developed, methods for the creation of software systems were designed and promulgated and technologies were stabilized and became more reliable, the need for highly paid specialists reduced. The only blip on this otherwise smooth path towards commoditization was Year 2000 and the global panic that ensued, but the effects of this were short lived. There are plenty of similarities to the changes we have witnessed in project management, but there are also at least four additional factors that have accelerated the commoditization of the software professional. The first is increasingly held belief that IT no longer matters because it is so much part of the fabric of the average organization that it is no longer capable of generating strategic advantage. The second is the rise of highly educated software engineers further east and especially in India. This has allowed companies to develop systems to similar or higher levels of quality but at a fraction of the cost. Heinrich von Pierer of Siemens summed this up incredibly well when he said: 'For the same money it takes to hire 2,000 German software developers, I can get 12,000 in China. This process is commonly known as labour arbitrage. The third is the dominance of a small number of software platforms and applications that have allowed organizations to standardize their use of IT and eliminate the need for bespoke systems. And finally, the ongoing maintenance of software has been pushed out to lower cost providers because it is no longer perceived to be core to the business. The impact has been to depress the incomes of the software engineering professional and reduce the margins of those providing IT services, mainly through increased competition and the availability of cheap labour.

Simple examples perhaps but they begin to illustrate the forces and factors which are helping to bring commoditization onto the agenda of a wide range of organizations, both large and small. Of course, if it was just about the commoditization of certain types of resources, then maybe organizations wouldn't need to worry. But there are other things to consider which are also helping to drive commoditization deep into the heart of the corporation. Some of the factors which are bearing down include:

x The intellectual competition coming from Asia, and especially India and China who now produce some four million graduates every year. What makes this number even more daunting is

the fact that between 30 and 50 per cent of these graduates are unemployed in their home countries, which leaves a vast number of intelligent workers to be mopped up by the global economy.

x Western economies are aging fast and have to adjust to the realities of longer working lives with a less productive workforce. This represents a major issue for employers who have to deal with the problem of motivating middle aged employees who are feeling increasingly disaffected and rejected (both by their employers who have failed to live up to the promise of lifetime employment which offered progression and challenging careers and by the state itself, which is no longer capable of providing for them in their old age). This is something that a recent Harvard Business Review article termed midsenescence. The article claims that this is a major issue confronting large numbers of organizations and according to its authors, organizations which fail to deal with the issues that midsenescence presents are sitting on a time-bomb that will continue to tick louder and louder as the

x Baby boomers on which today's organizations were built retire in droves. Given that fifty per cent of the working population can be considered midsenescence, this is something that isn't going away. In another recent book, *The Living Dead*, David Bolchover outlines the sheer waste that exists in the typical organization; staff who are bored, unproductive, surfing the net and doing very little in the way of work all contribute to the sense of futility that many workers feel in their working lives. Ironically the lack of productivity, motivation and innovation that is associated with midsenescence and the living dead provides a healthy breeding ground for the further commoditization of work. Organizations will have no choice but to seek out more productive, innovative and effective employees, principally overseas, in order to insulate themselves from the impact of a disaffected and unproductive workforce.

x Just as the number of smart graduates increases in the East, the number declines in the West. Fewer students are pursuing science and engineering degrees which is making it much harder for companies to innovate. There seems to be a misconception that creative degrees will be the engine of growth for the future economy; creative does not automatically equate to innovative. This makes it difficult for corporate to escape the commoditization trap and sets them on a path to obsolescence. There is also a noticeable dumbing down in education levels which is exacerbating the problem. But that is not the whole story, because the number of jobs which genuinely require graduate level capabilities is declining due to the impacts of technology and process driven change (see next points).

x Technology continues to disrupt the status quo, opening up new opportunities to competitors and facilitating the shift of labour to low cost economies. This is especially true of the internet which is making it much easier to compete on cost, which increasingly matters in a globalized market. As well as opening up new competition, technology continues to eliminate high paying jobs as business processes are subsumed into enterprise wide and package-based applications.

x Work continues to be codified and systematized in order to increase the efficiency of core business processes so that organizations can reduce their overheads and focus their capital on innovation and maintaining or reducing the costs of their goods and services. Achieving a balance is not easy, but the majority of organizations will have little choice but to maintain a focus on cost containment in order to compete. When the balance is wrong it can set the organization onto a downward spiral of cost cutting and lower performance which can result in their ultimate failure.

The fundamental problem with competing on cost is that there is always someone else who is willing to cut their costs even further than you.

x There is a growing imbalance between the number of graduates and the jobs that require graduate level skills and capabilities. In the past it was possible for graduates to walk into well paid jobs and expect a career which allowed them to both apply their new found expertise and offer them long-term progression. However because the number of graduates has been growing faster than graduate level jobs there is now a glut of degree holders. According to the US Labour Department's Bureau of Labour statistics there are 2.6 graduate job seekers for every graduate level job. People with graduate level skills working in jobs which do not require those feeds the turn-up and tune-off approach of dealing with the 7-10 hours they spend in the office – the living dead as mentioned above. And although not in the middlescent zone just yet, it won't be long before a whole new tranche of demotivated employees enters that difficult mid-career period.

x A whole generation has been brought up in a world where goods and services can be obtained cheaply. Unless we are dealing with luxury goods, no one wants to pay more than they have to for the products and services they buy. The availability of cheap goods and services has been significantly enhanced through the internet, where prices can be readily assessed and where it is possible for one product/service to be compared to another, with the lower cost provider usually winning out and from the influx of well educated immigrants who are willing to work for lower incomes. However, there are downsides to this focus on cost. First as it forces organizations to concentrate on their costs and overheads to the detriment of everything else. Not a bad thing perhaps, but when this begins to affect peoples' income and employability it starts to create issues. Second it makes it harder for them to innovate and build the products and services on which their future depends. And finally it starts them onto the race to the bottom, where the death spiral of cost reduction leaves the organization hollowed out and bereft of the talent it needs to survive in a commoditized world.

These and many other factors work together to create an environment in which the commoditization of products, services and people is possible. Commoditization may not be new for some, but for many it is a new reality that needs to be understood and responded to. There is little point in hoping that it will not happen to your business or you as an individual because hope is not a strategy.

2. The commoditized zone

Commoditization is a very real threat to every organization and it is comparatively straightforward to identify the early warning signs, which include:

- x Increasing competition
- x Prevalence of me-too products and services
- x A belief that all suppliers are fundamentally the same
- x The decreasing desire on the customer's part to look at new options or features
- x An increasing preference for customers to select on the basis of price and little else
- x A reluctance for customers to pay for anything they consider unnecessary
- x Increasing pressures on margins.

Strong brands might help to insulate the organization from some of the worst impacts, but as we have seen in the past with organizations such as IBM, even the strongest and most dominant organizations come under threat from time to time. Even for those organizations which operate

within a safe sector, such as energy for example, commoditization is still an issue they have to address, especially in terms of their non-core activities. At its extreme, commoditization leaves the leaders of corporations with a very simple and stark choice: do we allow ourselves to become commoditized and hence do our best to survive, or do we do our best to avoid it? Of course for some, the former may be the only choice open to them and for many it will probably be a mix of both. Naturally there is a strategic choice involved as some organizations can be considered to be driving commoditization. In doing so they are gaining first mover advantage. Take Easy Everything, which has a range of companies under its umbrella which are initiating a wave of commoditization in a number of sectors, most notably Easy Jet, but also cinemas, car hire, cruise liners, and hotel accommodation. As the zone of commoditization continues to expand, organizations must do everything they can to ensure they can compete without either destroying the value they offer to their customers or going out of business because their underlying costs are just too high to compete with the leaner more efficient companies which are emerging from India, China, South America and Asia. These companies are able to lower their prices without destroying their business.

Of course commoditization is not just about organizations; it is also about people, especially because the success of any business depends on having staff with the right mix of skills, attitudes and behaviours. We have been hearing for a long time now about the war for talent and how this is going to affect the viability of corporation everywhere. More recently, and as some of the points made above allude to, we have had our attention diverted to the impacts of the impending loss of the Boomer Generation. All this is fine, but the war for talent only really affects a comparatively small number of employees with the experience and expertise which is currently in demand and the Boomer Generation won't all be retiring tomorrow; in fact the last boomer won't be hanging up their boots for another 18 years and perhaps longer given that so few of them have saved enough to retire with a comfortable income. If we look back only a few years the war for talent was a huge issue until downsizing hit the corporate world and the combined impacts of the September 11th terrorist attacks and the bursting of the tech bubble ensured that the war for talent was placed firmly on the back burner. But the war for talent is not a static phenomenon because the skills required in the workplace continually shift. Whilst IT and especially knowledge of legacy applications was in high demand in the last few years of the last century, the emergence of highly skilled Indian IT experts has essentially commoditized IT to the point where staff and consultancies alike can no longer command the six figure salaries they got used to. No more war for talent here then – despite all the doom laden projections claiming that there were not enough software engineers to cope with the anticipated demand for technology solutions. If you look across the wider economy, it seems that the war for talent is shifting to a war for low grade operational staff. Such people are either required to serve others in the increasingly service oriented economy or act as glorified machine minders. An extreme view perhaps, but the impact of technology is dumbing down the world of work to the point where the glut of graduates both here and the emerging economies will wind up in jobs which will barely test their skills. This hollowing out is something that Charles Handy discussed in his book the *Empty Raincoat* as far back as 1994. His metaphor was the doughnut in which the essential core of the organization which contained all of the necessary jobs and employees is surrounded by an open and flexible space which is filled by contractors, consultants and these days' outsourcers. Coming back to the war for talent, it is clear that Handy's model

provides another lens through which this can be viewed. The talent war, as far as it exists, is raged at the core of the doughnut not necessarily beyond it.

Commoditization is therefore a significant threat to the traditional career. The requirement to reinvent oneself many times over during working life, long a mantra of the management guru, is becoming a reality for many. Reinvention may mean job changes for those seeking challenge and opportunity outside a single organization or it might mean adapting to the changing organizational setting for those who remain within a single company over their working life – although this is becoming increasingly unlikely. Whatever form it might take, it is a skill that few genuinely have. Ensuring that skills, expertise, attitudes and behaviors remain in synch with the local and global economies is vital for the future employee. With China and India churning out vast numbers of intelligent graduates who are willing to work (at least for the time being) for a fraction of what it costs to employ a Western equivalent, the current wave of outsourcing and off shoring is unlikely to slow anytime soon. What is significant is that the current and future waves of both outsourcing and off shoring will be focused on white collar work. Manufacturing has been declining in the west for so long now that there is little left to offshore which makes white collar work the next and most obvious target.

But before organizations and individuals throw up their arms in despair, it is important to note that commoditization is not all bad and if approached in the right way the organization and individual can succeed. What is clear is that there is a choice involved and that choice is about responding to the threats and opportunities which commoditization represents.

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