

2.6.6: Best-Cost Strategy

Learning Objectives

1. Describe the nature of a best-cost strategy.
2. Understand why executing a best-cost strategy is difficult.

Table 5.9 Best-Cost Strategy

Firms that charge relatively low prices and offer substantial differentiation are following a best-cost strategy. This strategy is difficult to execute, but it is also potentially very rewarding. Several examples of firms pursuing a best-cost strategy are illustrated below.

Southwest Airlines provides low cost flights to vacations destinations such as San Antonio, San Diego, and Orland. While many airlines make passengers feel like cattle loaded on to a truck, Southwest creates fun by, for example, getting children excited about visiting Sea World when they see this custom Shamu plane design.	Chipotle Mexican Grill relies on organic ingredients to create very tasty burritos that are sold at prices comparable to those of fast-food restaurants. When noon arrives, many hungry people prefer to spend their lunch dollars on a top-shelf burrito rather than a greasy burger combo meal.
Target offers extremely competitive prices, but the firm also differentiates itself from other discount retailers by carrying products from trendy designers such as Michael Graves, Isaac Mizrahi, Fiorucci, and Liza Lange.	Pabst Blue Ribbon is offered at an extremely low price and its taste (or lack thereof) is comparable that to other inexpensive beers. “PBR” enjoys brand loyalty, however, due to its high name recognition. The frequent appearance of PBR’s well-known logo on signs, T-shirts, and other merchandise has helped make PBR an enduring favorite among beer consumers with light wallets.

The Challenge of Following a Best-Cost Strategy

Some executives are not content to have their firms compete based on offering low prices or unique features. They want it all! Firms that charge relatively low prices *and* offer substantial differentiation are following a best-cost strategy (Table 5.9). This strategy is difficult to execute in part because creating unique features and communicating to customers why these features are useful generally raises a firm’s costs of doing business. Product development and advertising can both be quite expensive. However, firms that manage to implement an effective best-cost strategy are often very successful.

Target appears to be following a best-cost strategy. The firm charges prices that are relatively low among retailers while at the same time attracting trend-conscious consumers by carrying products from famous designers, such as Michael Graves, Isaac Mizrahi, Fiorucci, Liz Lange, and others. This is a lucrative position for Target, but the position is under attack from all sides. Cost leader Walmart charges lower prices than Target. This makes Walmart a constant threat to steal the thriftiest of Target’s customers. Focus differentiators such as Anthropologie that specialize in trendy clothing and home furnishings can take business from Target in those areas. Deep discounters such as T.J. Maxx and Marshalls offer another viable alternative to shoppers because they offer designer clothes and furnishings at closeout prices. A firm such as Target that uses a best-cost strategy also opens itself up to a wider variety of potentially lethal rivals.

Developing a Best-Cost Strategy at Plain Ivey Jane

According to government statistics, women are 60 percent less likely than men to become entrepreneurs. Meanwhile, succeeding within the specialty fashion retailing market is notoriously difficult. These trends do not worry Sarah Reeves, a young entrepreneur and 2007 graduate of Auburn University who is rapidly becoming a key player within the Austin, Texas, retail scene by offering high-end fashion at low prices.

On her website (<http://www.plainiveyjane.com>), Sarah describes Plain Ivey Jane as “the go-to place for women who want to elevate their wardrobes. We offer high end designer names at a discount, and the new overstocked apparel is handpicked from over 70 different brands to offer exactly what Austin needs at a price every girl can afford. To pair with your fabulous new wardrobe, Plain Ivey Jane carries accessories from undiscovered local artisans.” We asked Reeves to discuss her firm (Ketchen & Short).

Question:

Can you tell us a little about your Plain Ivey Jane concept?

Sarah Reeves, Owner:

Plain Ivey Jane sells overstock from Anthropologie, Urban Outfitters, Bloomingdales, and other high-end and small designers. Although I buy from the same designers as the big and famous retailers, our dresses and accessories are sold at a fraction of their prices.

Question:

What differentiates your boutique from competitors?

Reeves:

I'm one of the lowest-priced retailers in the shopping district that people in Austin call the Second Street area. My niche in the fashion retailing business is that my merchandise is overstock from great brands. There's maybe one other business in Austin that sells overstock. What makes my concept different is that it has the feel of a high-end retail store versus a basement feel of the typical discount retailer.

Question:

Do have a lot of regular customers?

Reeves:

Yes. Once people find out what I offer, they're in here all the time. I see the same group of people every few months, but getting in new faces is the challenge. I think a lot of people walk by and assume that our clothes are expensive, but nothing could be further from the truth.

Question:

Were you fearful of starting your own business so young?

Reeves:

No, I figured this was a great time since I had nothing to lose. I thought getting it out of my system now was a good idea, and it was a good time since I was able to get a great deal on my lease. With the downturn in the economy, the time was right for my lower-priced strategy.

Question:

What would you say is the biggest key to success for small business?

Reeves:

Flexibility. Rolling with the punches and definitely the ability to follow up with people. I thought that people who owned their own business must know what they are doing, but many people don't. At this point, I prefer to do everything myself. At least I can blame myself when things go wrong.

Another key is networking with other small-business owners. A lot of the other boutique owners nearby have become close friends. I learn what works for them and what might possibly apply to my concept.



The success that 2007 college graduate Sarah Reeves has enjoyed with Plain Ivey Jane may inspire other young women to become entrepreneurs.

Nit Ng – [Clothes Store](#) – CC BY-NC-ND 2.0.

Table 5.10 Driving toward a Best-Cost Strategy by Reducing Overhead

Many firms would like to use a best cost strategy but struggle to meet the strategy's dual requirements of charging low prices and providing differentiation features. One way to help make best cost a reality is to use a business model that slashes fixed costs. Amazon.com, for example, can charge low prices in part because it does not have to absorb the overhead involved in operating stores. Similarly, some talented chefs are pursuing a best cost strategy by operating food trucks and thereby avoiding the overhead required to run a restaurant such as rent and utilities. SEveral examples are illustrated below.

For about the same price as a Subway or Jimmy John's sandwich, Counter Culture in Austin, Texas, provides vegan offerings such as their Garbonzo "Tuna" sandwich.	Owners Kahala and Kat founded Ninja Plate Lunch in Portland, Oregon, to offer large portions of delectable Hawaiian foods cub as pulled pork for only around \$5.
PBJ's offer unique sandwiches with organic peanut butter at the heart of many of their creations. The traditional PB and J is a staple nationwide, but customers will travel far to get the "Hot Hood" with Challah bread, black cherry jam, jalapeño, apple wood-somked bacon, and PBJ's peanut butter for only \$5.50.	In the smash hit graphic novel <i>Tales of Garcón: The Franchise Players</i> , the Tapas Taxi takes the concept of a cheap taxi ride to a new level by also offering passengers a variety of "tapas." These Spanish snacks are top shelf, of course!

Pursuing the Best-Cost Strategy through a Low-Overhead Business Model

One route toward a best-cost strategy is for a firm to adopt a business model whose fixed costs and overhead are very low relative to the costs that competitors are absorbing (Table 5.10). The Internet has helped make this possible for some firms. Amazon, for example, can charge low prices in part because it does not have to endure the expenses that firms such as Walmart and Target do in operating many hundreds of stores. Meanwhile, Amazon offers an unmatched variety of goods. This combination has made Amazon the unquestioned leader in e-commerce.

Another example is Netflix. This firm is able to offer customers a far greater variety of movies and charge lower prices than video rental stores by conducting all its business over the Internet and via mail. Netflix's best-cost strategy has been so successful that \$10,000 invested in the firm's stock in May 2006 was worth more than \$90,000 five years later.¹



Hey Cupcake! in Austin, Texas, is a low-overhead bakery that has become a delicious success.

Evan Bench – [Hey Cupcake!](#) – CC BY 2.0.

Moving toward a best-cost strategy by dramatically reducing expenses is also possible for firms that cannot rely on the Internet as a sales channel. Owning a restaurant requires significant overhead costs, such as rent and utilities. Some talented chefs are escaping these costs by taking their food to the streets. Food trucks that serve high-end specialty dishes at very economical prices are becoming a popular trend in cities around the country. In Portland, Oregon, a food truck called the Ninja Plate Lunch offers large portions of delectable Hawaiian foods such as pulled pork for around \$5. Another Portland food truck is PBJ's, whose unique and inexpensive sandwiches often center on organic peanut butter. Beyond keeping costs low, the mobility of food trucks offers important advantages over a traditional restaurant. Some food trucks set up outside big-city nightclubs, for example, to sell partygoers a late-night snack before they head home.

Key Takeaway

- A best-cost strategy can be an effective business-level strategy to the extent that a firm offers differentiated goods and services at relatively low prices.

Exercises

1. What is an example of an industry that you think a best-cost strategy could be successful? How would you differentiate a company to achieve success in this industry?

2. What is an example of a firm following a best-cost strategy near your college or university?

¹Statistics drawn from Standard & Poor's stock report on Netflix.

References

Ketchen, D. J., & Short, J. C. Forthcoming. The discount diva: An interview with Sarah Reeves. *Journal of Applied Management and Entrepreneurship*.

This page titled [2.6.6: Best-Cost Strategy](#) is shared under a [CC BY 4.0](#) license and was authored, remixed, and/or curated by [Jamie Hammond and Western Technical College](#).