CASE 2:
DRYWALL COMPETITIVE THREAT

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Firm Style	Interview Round
BCG / Bain	1 / 2

Case Question:

Our client is a dry wall manufacturer and is concerned about a new player coming into the market. The new player is perceived to be a low price player and our client is considering lowering its price by 10%. The client seeks our advice regarding its options.

Clarifying Questions & Answers

Provide the following answers only if the interviewee asks the corresponding questions.

Question	Answer
How many products does the client produce?	One
Is the new competitor's product similar to ours?	For practical purposes we can assume that our product is similar to the new competitor's product.
How are "dry-wall" products differentiated?	For our analysis assume all the "dry-wall" products in the market are similar.

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Framework / Structure

This is a strategy/competitive type case. A comprehensive plan should include the following areas:

- Client's impact of reducing price by 10%
- Market Structure (# of competitors and their share)
- Customer:
  - Who Are They?
  - Customer Preferences
  - Price Sensitivity
- New Competitor:
  - Size
  - Strengths
  - Weaknesses
- Our Client's Position:
  - Market Position
  - Duration in the Market
  - Brand Strength

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Question 1: After the candidate lays out his or her plan, ask the candidate to analyze the impact of 10% price reduction on our client's bottom line. Give the following information when asked:

a. Number of units sold = 100,000
b. Selling Price Per Unit = $10
c. Variable Cost Per Unit = $3
d. Allocated Fixed Cost Per Unit = $2

Key Assumption:
If the candidate asks regarding the volume change with the price cut, state that the volume **will remain same** with the price cut. If the candidate does not ask about the volume change it is expected that the candidate explicitly state the assumption before proceeding to the calculation.

Expected Calculation:

- Total Fixed Cost = $100,000 * $2 = $200,000
- This is a key insight: the allocated fixed cost needs to be converted into total fixed cost.

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Original Case:

- Revenue = $10 * 100,000 = $1,000,000
- Variable Cost = $3* 100,000 = $300,000
- Contribution Margin = $1,000,000 - $300,000 = $700,000
- Profit = $700,000 - $200,000 = $500,000

Price Cut Scenario:

- New Price = $9
- Revenue = $9 * 100,000 = $900,000
- Variable Cost = $3 * 100,000 = $300,000
- Contribution Margin = $900,000 - $300,000 = $600,000
- New Profit = $600,000 - $200,000 = $400,000

Impact On Bottom Line:

[(New Profit – Old Profit)/(Old Profit)]

Impact on bottom line = ($400,000 - $500,000)/$500,000 = -$100,000/$500,000 = -20%

The candidate is expected to state that the impact on the bottom line is 20% and thus is magnified compared to the 10% price cut.

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Question 2: Now ask the candidate if our client maintains the price how much volume it potentially needs to lose to make it equivalent to cutting the price by 10%.

If the candidate takes the initiative and explores this question then it needs to be noted and encouraged (this differentiates a very strong candidate from others)

Expected Analysis: Let the new volume of units the client sells be "x", and if the client sells "x" units @$10:

- Revenue = 10*x Variable Cost = 3*x Fixed Cost = $200,000
- Profit = 10x -3x - $200,000

*A classic mistake is to take the contribution per unit as $5 (effectively treating the allocated fixed cost as a variable cost too) and using $5*x as the profit.*

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So for this option to be equivalent to cutting the price by 10% the equation would be

- 10x – 3x – 200,000 = 400,000
- 7x = 600,000
- x = 600,000/7 = 85,700 (approx)
  Loss in market share = (85,700-100,000)/100,000 = 14.3%

It is expected that the candidate explains what this 14.3% number represents; expected answer
would be that the 14.3% is the maximum market share our client can afford to lose before the option of cutting price by 10% appears to be a better choice.

A candidate can differentiate himself or herself by stating that the key is to estimate how much the client can potentially lose if it does not reduce price by 10%.

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Question 3: Now ask the candidate that if our client needs to make a choice between these two options how you would help our client make the choice.

Now the candidate is expected to make use of his or her plan to help make a decision. If candidate asks the following questions provide the following information:

- What is the market structure? (In terms of number of competitors and their share)
  - Show Exhibit 1, with the shares
- What is size of the competitor?
  - They are a small to mid size player
- Who are our customers?
  - They are primarily contractors/small business owners. They buy directly from us.
- What are our customer's preferences or how price sensitive they are?
  - Customers usually buy based on relationships and they build preference on a particular brand. We do not have any information regarding price sensitivity.

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- How do we sell to our customers?
  - We sell based on their orders. There are no long term contracts.
- What are the strengths of the new competitor?
  - Not much information, they are a new player in the market. They have presence in other market our client does not compete in.
- What are the weaknesses of the new competitor?
  - Not much information, they are a new player in the market. They have presence in other market our client does not compete in.
- What is our brand strength?
  - As a number 3 player, we have strong brand presence and we have been in the market for a significant period of time.
- How long we have been in the market?
  - We have been in the market for a significant period of time.
- Is there much differentiation in the product?
  - Not much, for practical purposes consider all products to be similar.

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Key Expected Insights

Based on the information provided the candidate is expected to come up with at least the following insights:

- Dry wall market is a very fragmented, and we are a dominant player
- Considering the size of the competitor, they would be one of the small 30+1 players
- That would mean on an average the new competitors' market share would be around:
  - 70/31 = 2.3% approx
- New Competitor assuming fair share draw would take 2.3% of our volume, although one can argue that they may not take any volume and compete with the other small/mid size 30 players

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Recommendation

The recommendation should include the following:

- The answer: Client should not reduce price, because this is not a serious threat and cutting price in this market would lead to a price war where everyone would lose.
- The number(s): Reducing the price by 10% would impact profit by 20%. 20% impact on profit is equivalent to losing 14.3% market share at the current price levels and at most the client can lose 2.5% volume.
- Risks or considerations:
  - We might underestimate the size or strength of the new competitor (new competitor might be bought by a bigger player)
  - One of the major competitors (A or B) may have a knee jerk reaction and reduce price
- Next steps:
  - To mitigate some of the risks our client should aggressively strengthen its client base by providing additional services
  - To create a barrier for the new competitor to poach our client's customers
    - Client can enter into long term contracts with its customers
  - Even if A or B reduces its price, our client should maintain price and aggressively provide value added services to the customers.

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Exhibit 1