THE SOAP AND OTHER DETERGENTS MANUFACTURING INDUSTRY: TRENDS AND CHARACTERISTICS

A Report of the Center for Competitive Analysis

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This report, prepared by the Center for Competitive Analysis of the University of Missouri Outreach and Extension (UO/E), provides an overview of the Soap and Other Detergents Manufacturing Industry ("soap industry"), Standard Industrial Classification (SIC) code 2841.[1] Its primary intended audiences are UO/E, which may consider educational programming designed to assist business owners and workers in the industry, and economic development policy makers, who can use the information contained herein to learn more about the industry and develop programs designed to attract or retain businesses in this industry. It is by no means intended to be an exhaustive survey of all aspects of the industry. Furthermore, because soaps are part of a broader class of products—"personal care"—the report will touch upon some issues that go beyond the narrow confines of the soap industry. The final section of the report identifies issues that will have to be studied in greater depth before educational or developmental programming can be designed.

1. General Industry Information

The soap industry includes companies primarily engaged in making soap, synthetic organic detergents, inorganic alkaline detergents, and crude and refined glycerin from vegetable and animal fats. In 1997, the latest year for which U.S. Economic Census data are available, this industry had 799 establishments[2] nationally. There were roughly 29,000 employees in total ($1.18 billion payroll), including 16,749 production workers ($576 million payroll). National total value of shipments was $16.8 billion, of which $9.8 billion represented value added. More detailed data are available from other sources, but it is not clear how well the categories by which such data presented correspond to overall census data for the industry. Assuming a reasonable correspondence, it appears that in 1998 U.S. laundry detergent sales were $4.4 billion, skin care sales were $2.6 billion, and the sales of personal soaps (bar soap, body wash, and liquid hand soap) totaled $2.2 billion. In the latter category, about 85% of the retail market is split evenly between supermarkets and discounters, with drug stores accounting for the remaining 15%. Over the past year or so, unit volumes of personal soaps have fallen slightly while dollar sales have increased slightly. Traditional bar soaps, which are considered a "mature" category, exhibit very low growth, while newer products (shower gels and body

[1]This largely corresponds to the new North American Industry Classification System (NAICS) code 325611. NAICS 325611 includes the "toothpaste" portion of SIC 2844 (Toilet Preparations) in addition to SIC category 2841, but virtually all of the new NAICS 325611 (approximately 99%) is from the latter.

[2]The number of companies is slightly lower; some companies operate multiple establishments.

washes) and specialty products such as antibacterial and natural soaps still present ample opportunities for growth. See the Product Market section below for more discussion of market niches and segmentation.

Missouri's share of value of shipments in 1997 was approximately $1.66 billion ($1.2 billion value added). There were 35 establishments in Missouri, 11 of which had 20 or more employees. The industry employed a total of 1,858 persons in Missouri ($69.5 million payroll), of which 1,370 were production workers ($46.3 million payroll). According to *MarketPlace* data for early 2000, a significant majority of Missouri's soap workers were employed in just a few plants located in the St. Louis and Kansas City areas. Most of the small number of establishments found outside the major metropolitan areas are located in southern Missouri. These "outstate" firms are generally small, with many employing fewer than 10 workers.

Data from 1992 regarding the overall concentration of the industry reveal that much of it is controlled by a relatively small number of firms. The four largest firms controlled 63% of total industry value added, the top 20 firms controlled 85% and the largest 50 firms had 91%. In comparison, the top 50 firms regardless of industry controlled 24% of the U.S. total value added for manufacturing. But while this industry is clearly more concentrated than the overall economy, dominance by a few firms is due to the existence of a handful of very large producers (Procter & Gamble, Unilever, Dial, and Colgate-Palmolive) whose presence is mainly felt in a few submarkets, such as laundry detergents and traditional bar soaps. Therefore, although it would be difficult to battle the big companies in such mass market areas, it is quite possible for small companies to compete in a number of smaller market segments or niches.

2. The Product Market: Who, What, and Where?

Who are they?

As is the case in many other markets, the soap and personal products industry is being driven to a large extent by the changing age composition of the population, specifically by the bulge of the baby boom "passing through the snake." For example, baby boomers have established anti-aging preparations as the chief benefit of cosmeceuticals (products aimed at correcting or improving the physiological condition of the skin). Now turning age 50 at the rate of one every 7 seconds, U.S. baby boomers have put anti-aging on the top of the cosmeceutical benefit list. Two-thirds of this group approve of concealing aging signs, which resulted in driving the cosmetic surgery market up 47% in 1999 and spurring an increase in wellness product growth. It is for good reason, then, that baby boomers are the focus of many personal care product manufacturers. They have led the broad personal care sector of the economy to focus on the potential in aging consumers and their expanding pocketbooks. Growth is occurring in a variety of age-sensitive product markets, from soaps and skin creams to massagers and body fat analysis machines. Other trends are discernable as well. Not only are the boomers aging, which will drive spa and wellness categories to new heights, but they are entering their peak earning years. As their lives get busier, stress relief products will become more important to them.

The group composed of 45-year-old to 54-year-old females is responsible for the highest amount of sales of body care and bath products in mass stores. And consumers with an annual household income of $70,000 are spending the most in mass for bath products. Furthermore, 40% of female skin care shoppers describe themselves as "ecologists," implying that environmental considerations are also becoming more important. Consumers in this category are also more active in personal care markets, spending, for example, $170/year on skin care, or 25% more than the U.S. average.

Few areas within the personal care sector remain unaffected by the changing population composition. Even retailers like Brookstone and Sharper Image expanded their interest in branded personal care items. Not only was more retail space dedicated to the products, but they were often placed in specific "spa shops" within the store, with displays used extensively to merchandise the category.

Baby boomers are not, however, the only group important to the growth of this industry. The number of personal care products designed specifically for children is increasing. Health and beauty aids suppliers are using licensing to tap into the growing spending power of children. Estimates suggest that children between the ages of 4 and 12 spend about $27.1 million of their own money each year. Recognizing children's power to influence parents' purchases, suppliers have adorned their products with the images of characters from popular child-oriented movies and television programs. Minnetonka Brands Inc., has developed scrubbers for its shampoos and body washes that resemble Warner Bros. "Looney Toons" characters Taz and Tweety. Marketers of kids' personal care products that are not licensed are more likely to utilize advertising or promotions.

What are they buying?

All of these changes in the age composition and affluence of the U.S. population have important ramifications for makers of soap and other personal products. Companies making more "traditional" products must carefully review their marketing and other business strategies in order to adapt to the transformed market. The changes also create better opportunities for new companies to enter particular market segments. The mass bath and body care category has made recent introductions reflective of several trends that department stores, salons, and specialty boutiques have been offering for years. The demand for space, which is increasing as a result of product innovation, is causing some companies to replace older well-known products with newer ones that contain special formulations.

New product activity and the increasing popularity of the bath and body market helped sales of bar and liquid soap increase last year. A growing perception among consumers that they must deal with problem skin and rising levels of concern about germs are helping drive sales of personal soap. Although traditional brands such as Dove, Dial, and Irish Spring still hold the largest portion of the toilet soap market, smaller specialty soap companies are increasing their market shares. And while the bigger players such as Colgate-Palmolive, Unilever, and Procter & Gamble slug it out in segments such as antibacterial soaps, smaller companies are reaping the rewards by focusing on specialty soaps. Consumers want a soap that fits their particular needs and specialty soaps, often made with natural ingredients (see below), fit the bill.

Bar soap sales accounted for 62.7% of dollar sales for bath and hand soaps in 1998, making bar soap by far the largest segment in the hand and bath soap category. While liquids and gels for personal cleansing have become a fact of life, the traditional soap bar is fighting back, initially with translucent soaps and now with transparent products. A number of manufacturers of liquids and gels are now also looking at the new clear bars as a way of extending their market coverage. Increasingly popular are specialty soaps, such as those with some sort of historical connotation or with protection from ultraviolet (UV) radiation. Smaller companies are attempting to break into the market with such specialized goods. For example, Medieval, based in Los Angeles, CA, offers oils, soaps, bath blends, perfumes, and lotions with a Camelot theme.

While bar soaps remain the largest segment and have been growing at a low rate in absolute terms, there has been a relative shift away from bar soaps toward liquid soaps. Many women feel that body washes are superior because they both moisturize and provide long-lasting fragrance. Del Laboratories Inc., which pioneered the natural trend in the mass retail market, is launching the Rainforest, Island, and Orient body washes and hand and body lotions in the spring of 2000 under its Naturistics brand. Shower gels are focusing as much on exotic fragrances as on offering effective cleansers. Louis Davis of The Delhar group notes that the Generation Y groups are very interested in the kinds of fragrances they use. “Customers come into a store and see rows of shower gels and liquid soaps, many of which come in very colorful containers and have exotic scents that say, ‘escape from your troubles,’” says a store manager at a Northeastern discount chain. “Those fragrances, as well as the moisturizers that these products contain now, make them more popular than bar soaps.”

One important segment within the personal care products market is “natural” preparations. It is predicted that the personal care market for natural products in the U.S. will total $3.9 billion in 2000, with skin and hair care sales leading the way. This trend is expected to be a key driver of growth in soaps and personal care products as we move into the next century. According to a recent survey by Prudential Securities, purchasers of natural health and beauty aids rose to 64% of all consumers of health and beauty aids from 55% just two years ago.

“This long ago went from a niche market to a mainstream trend,” says a skin care buyer for a Northeast chain of food and drug stores. “There is what can be described as the ‘hard-core’ naturals consumer, who is more likely to shop for hand and body lotions in a health food store than in a supermarket. But a large number of mainstream mass market shoppers are looking for natural ingredients and such things as no-animal-testing in their health and beauty aids products.”

This interest in natural products springs from a combination of concerns. Many consumers have become more wary of using personal care products containing harsh chemicals. In addition, the natural products are perceived as being more environmentally friendly. The growing interest in wellness products, particularly herbal and other natural items traditionally sold through health-food stores, has spilled over into consumer preferences for personal care products containing many of the same ingredients. Scar gels with onion extract, circulation creams for tired skin containing ginseng and gingko, anti-itch preparations with willow bark, and anti-ache creams with capsaicin and arnica are becoming more widely used. Ingredients obtained by taking only a small part of the plant and letting the rest grow are also gaining prominence.

The naturals trend is also evident in the ethnic segment of skin care. “Ethnic consumers are seeking multi-functional products full of botanicals and vitamins,” says Penny Williams, brand manager for Black Opal, a product of BioCosmetic Research Labs. To address those needs Black Opal is launching a new class of skin care products and a technologically advanced line extension to an established item. The company works closely with mass market retailers to help them capitalize on opportunities in this segment of the market.

A cosmetic ingredient that illustrates the rising interest in products that are both “natural” and that are produced using ecologically preferred methods is shea butter. A product of the nut kernel of a tree in West Africa, it has been used there for hundreds of years, and cosmetic chemists have been investigating it for the past twenty years. It is claimed to have many beneficial properties, both as a skin cream and for other uses. Many African soap manufacturers use shea butter as a raw material. It is a versatile active ingredient that has excellent anti-aging, soothing, and moisturizing properties. Clinical studies have indicated that shea butter can help protect skin against climate and UV radiation, prevent wrinkle formation, and soothe irritated and chapped skin

The market at present has products that include butters extracted by using the solvent hexane, but the demand for natural products and traditional methods of production is changing this. Using shea butter obtained by traditional craft methods of mechanical crushing without chemical solvents is nearly becoming a market requirement. Green Belt, an organization promoting West African ecological interests, recognizes only environmentally sound products, and has certified mechanically crushed shea butter, making it the preferred choice.

A variety of other ingredients are widely used in skin care products, including soaps. These include alpha and beta hydroxy acids, Retin-A, natural fruit acids, and antioxidants, such as vitamins A, C, E, and Ester-C. Recently, Noxzema’s Nivea brand launched a multi-million dollar line of products containing Co-Enzyme Q10, which mimics one of the body’s own natural wrinkle defenses. Fruits, flowers, spices, nuts, and ingredients from the sea are also gaining in popularity as sources for natural skin care products.

Heightened consumer interest in natural and ecologically sound personal care products has allowed for the establishment and growth of firms producing exclusively for that market segment. Kirk’s Natural Products of Forest Park, IL, is relaunching its line of All Natural soaps. According to company literature, “Kirk’s Castile is known nationally for producing a good lather and rinsing quickly.” Red Dirt Soap company now has a full-fledged manufacturing facility in Bartlesville, OK. The Red Dirt bars last two to six times longer than commercial soaps, according to the company, and are made using only natural oils and spices.

Microencapsulation is a recent technology breakthrough that is greatly expanding manufacturers’ ability to offer consumers more effective products while bypassing the side effect of skin irritation that sometimes accompanies such products. It also allows for the use of otherwise unstable ingredients such as vitamin C in skin products.

Finally, private label products have become a major force in the bath and body care arena because of their ability to generate profits and help retailers differentiate themselves from competitors. Among bath products, store brands rang up $21.9 million in sales; ranking No. 2 in the Top 19 sellers of bath soaps for the 12 months ended December 5, 1999.

Where are they buying?

The major outlets for personal soaps are supermarkets, discounters, and drug stores. Supermarkets have the largest share, 43.3%, followed closely by discounters, which have been gaining rapidly on supermarkets in recent years, with 41.5%. Supermarkets are also important outlets for skin-care products, accounting for 25% of 1999 U.S. retail sales of such products. Supermarkets are more aggressively going after the latter market by using a “Whole Health Center” marketing approach. These are essentially departments within stores, offering one-stop shopping for a variety of health related items—healthy foods, dietary supplements, prescription and over-the-counter drugs, skin-care products, and other natural personal care goods. In addition, smaller natural skin care manufacturers are staying competitive by targeting skin-related over-the-counter drug markets.

Internet retailing of personal care products has grown rapidly, just as it has in many other retail sectors. Jupiter Communications, an Internet research firm, predicts that online sales of personal care products will rise in 2000 to $200 million and in 2003 to $1.2 billion. Several online retailers have been created, including Drugstore.com, which has a wide product selection, and Eve.com, which is limited largely to cosmetics.

Information and customization are two areas where online stores can shine. The amount of information a Web site can offer can be nearly limitless. One important advantage held by online sellers over stores with physical locations is the constraint caused by a lack of shelf space. Brick and mortar stores must carefully determine which products from which brands to give precious shelf space, but online sellers can carry a practically unlimited collection of products. Not only does this characteristic of online sellers allow them to “stock” a much wider variety of the products consumers want, it also provides an opportunity for small manufacturers to get their products in front of a national audience of consumers. One of the greatest difficulties faced by a firm wishing to enter a consumer goods market is persuading retailers that they will benefit by dedicating scarce shelf space to the manufacturer’s products. Online selling reduces that problem.

A potentially important negative aspect of e-commerce for personal products is the inability to feel and, especially, smell the merchandise. Many personal care products list fragrance as an important characteristic. To the extent consumers are already familiar with a specific product, this is not a problem, but getting a new product noticed might be more difficult.

As is the case in many other retail sectors, personal products sellers are finding that e-commerce involves more than just taking orders over the Internet. Tom’s of Maine (www.tomsofmaine.com) is the country’s leading manufacturer of all-natural personal care products. Tom’s has built its business on a commitment to being environmentally sensitive and socially responsible. Its full line of natural products is distributed in more than 30,000 health food stores and food and drug outlets. The products command a price premium of as much as 50%, yet by 1995 the privately held company's sales were $20 million. As Tom's developed its online order-taking capabilities, it made sure that customers could provide feedback and ask questions that would be answered individually. (Note: The article from which this was taken does not address the sometimes touchy issue of how a manufacturer's online retailing activities affect its traditional distribution chain.)

3. Labor, Skills, and Labor Market Conditions

The labor force employed by the soap making industry in Missouri is not generally characterized by high skill levels, although a small percentage of employees are in occupations requiring specific trade skills (e.g., electricians). The following table contains the occupational titles and the 1997 average annual wages of workers employed in the three-digit SIC category 284: Soap, Cleaners, and Toilet Goods Manufacturing. The table contains information for the six most heavily employed occupations.

TABLE 1. Soap Industry Occupations

Job Title	Percent	1997 Annual Average Wages
Packaging & Filling Machine Operators	8.3	$17,410 – $27,290
All Other Machine Operators	7.2	$14,165 – $22,235
First Line Production Supervisors	5.4	$24,461 – $43,846
Cleaning, Pickling Equipment Operators	4.9	$16,910 – $23,712
Hand Packers and Packagers	4.7	$11,731 – $17,555
Hand Material Movers, All Other	4.6	$13,811 – $21,112

The annual wage data are for all workers in Missouri in that occupational category, not just those in SIC 284. The "Percent" column states the percentage of the industry workforce classified in a particular occupation. The source of the information is the Missouri Occupational Information System (MOIS). Because these jobs do not require extensive skills, training would typically be done on the job, and there are no technical school programs designed to prepare workers for such occupations.

The table is based on overall industry employment in Missouri, which means that the occupational proportions are heavily weighted toward the largest employers in the state. These data may not therefore be appropriate for the smaller soap makers. Each soap making establishment, no matter how small, requires a minimum number—perhaps only one—of certain types of employees. As commerce moves more into the electronic realm, it will probably be necessary for even the smallest producers to have an employee who has relatively sophisticated computer skills that go beyond, for example, proficiency with a single word processing package. In order for a local area to attract and retain even small soap makers, it is therefore important for the nearby secondary and vocational schools to provide the kind of computer skill training required by such small businesses.[3] Even if the attitude, work ethic, and basic skills of the local workforce are sufficient in every other way, firms may be reluctant to locate in rural areas if workers with the requisite specific skills are unavailable.

An important reason why the educational system rather than the firms themselves will be the critical source for training in electronic commerce computer skills lies in the nature of the training. Economists distinguish between general training, which can be put to use by a worker in any of a number of firms or industries, and specific training, which is applicable only in individual or small groups of firms. Firms are more willing to provide specific training because the workers receiving it cannot easily (if at all) apply the knowledge gained to a job at another firm. The employer therefore need not be concerned with the possibility of investing what can be considerable sums in training only to see the employee leave for a more lucrative position with another firm. The sorts of electronic commerce computer skills at issue here are more general skills that are largely transferable from one employer to another. These principles apply to a greater extent in small businesses, for which training costs would be a larger proportion of total costs and which cannot offer their employees as many opportunities for intrafirm advancement.

Because labor market conditions vary considerably across Missouri, no blanket statements about labor availability in the state can be made, except to state generally that outstate labor markets are not as tight as those in urban areas. A good source of information on local (county) labor markets and a variety of other labor-related information for Missouri is the "Missouri Works" Web site at

http://www.works.state.mo.us/index.htm.[4]

A more general labor-related problem facing smaller businesses is the ability to maintain a competitive package of benefits, especially medical insurance. In today's tight labor market (especially with respect to workers with high skill levels), the ability to provide a strong benefits package may be the most critical factor in recruiting and retaining employees. In rural areas, the presence of one major employer with attractive benefits packages can leave smaller businesses in the area the choice between losing employees and incurring high benefits expenses.

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[3]This principle applies to a wide variety of industries in addition to soap making.

[4]Note that Web addresses and the contents of Web pages change from time to time. The Web addresses provided in this report were correct at the time of writing.

4. Physical Infrastructure[5] Requirements

Small and medium sized soap producers should require no special physical infrastructure. They do need some of the basic services required by all businesses, such as good road access for bringing in production inputs and sending out finished products. It is possible that larger producers may need large amounts of utility services which, depending on the chosen location of the production facility, may have to be constructed. And depending on the types of inputs used (e.g., "hard" chemicals versus all natural ingredients), certain kinds of environmental investments may be required. Generally speaking, however, there appears to be no such requirements that would pose an insurmountable constraint to even smaller communities trying to attract or retain soap makers.

5. Support Industries

No industry operates in a vacuum; none is self-sufficient. All require inputs to their production and marketing processes. As one small soap maker puts it, "Our company is independent in the sense that we make all of our own products . . . but there are some items that we must obtain from other industries. This would include some ingredients, product labels, containers, . . . and shipping boxes. I do not know of any company that does not need to rely on other industries to help them do their business." Not only must soap makers have access to vital inputs, they must also seek out low-cost suppliers as market forces lead them to cut costs. The rise of global markets can help, and purchasing professionals at soap and detergents companies are exploring foreign regions, including developing countries, for new sources of materials. In the previous two sections we examined features of the labor market and physical infrastructure that influence the performance of soap makers. In this section we will discuss some other factors—the structure of markets for non-labor inputs and the availability of a research base—that are important to the industry.

Soap makers—even the largest ones—do not for the most part maintain in-house chemical manufacturing capabilities. They must therefore purchase their raw materials from other suppliers. A recent trend among large soap makers is to reduce the number of suppliers used, a move that has both benefits and costs. "Supplier consolidation," as this trend is known, puts more business in the control of fewer suppliers, thus giving the suppliers that remain a greater incentive to provide superior service to their soap making customer. In addition, it is obviously easier and less costly to deal with a smaller number of suppliers for a given input. A drawback to supplier consolidation is that different suppliers have different strengths. Some may be very good at timely deliveries of high-quality inputs and responding to direct requests of the buyer, while others may be better at anticipating the buyer's needs or at providing auxiliary services such as inventory tracking. Implementing a successful supplier consolidation strategy therefore requires the buyer to carefully weigh the tradeoffs that will arise.

[5]By "physical infrastructure" we mean facilities such as roads, water supplies, sewer facilities, access to electricity and other types of energy, and telecommunications systems.

An important input for soap making is glycerine. Glycerine is used in a wide range of markets (but not in some "all natural" formulations), and its largest applications are in the pharmaceutical and personal care segments. Glycerine prices show signs of upward pressure after some price slippage during the first half of 1998. Market analyses attribute lower import levels and improved demand as reasons for modest, but steady, increases in glycerine prices through the end of the year. Most glycerine production in the U.S. occurs as a by-product of oleochemical production, including the manufacture of fatty acids and fatty alcohol. Actual production depends on the demand for oleochemicals as well as the capacity to refine the crude glycerine. The availability of natural glycerine is tied to demand for primary products such as soaps, sunscreen lotions, and skin lotions.

While soap is not perceived as a high-technology product, soap makers are always looking for a breakthrough product to boost sales, because having new, higher valued products is the primary way to improve profitability. But since most of the big soap makers, including Procter & Gamble, Unilever, and Colgate, divested much of their chemicals capabilities, they are turning to raw material suppliers to provide chemical expertise. For example, Cognis, a supplier of cosmeceuticals ingredients, is focusing its research on encapsulating systems that stabilize ingredients and ferry them through the skin. This opens up a range of ingredients that until recently were too unstable to use in most personal care products.

Beyond simply searching for innovative suppliers, soap makers and their raw material suppliers are expected to form more technology alliances over the next two years than they have in the past. This requires soap makers to develop a new culture, coming as they do from a background in which the manufacturers rarely share information with their suppliers.

6. Regulatory Requirements

Although there appear to be no industry-specific regulatory issues affecting soap makers, such firms must be aware of broader labor, occupational, and environmental regulations. Large companies typically have employees or entire departments devoted to following new regulatory developments and devising compliance procedures. In many small businesses, however, such responsibilities cannot be assigned to special experts. A good place to begin gaining a familiarity with federal (primarily employment) regulations the U.S. Department of Labor's *Small Business Handbook: Laws, Regulations, and Technical Assistance Services* (November 1997), available on the Internet at

http://www.dol.gov/dol/asp/public/programs/handbook/ofccp.htm.

Also of assistance to small businesses is the Department of Labor's Office of Small Business Programs. One of that agency's initiatives is the Regulatory Compliance Assistance program, available on the Internet at

http://www.dol.gov/dol/osbp/public/sbrefa/main.htm

or by toll-free telephone at 1-888-972-7332 (1-888-9SBREFA).

The U.S. Environmental Protection Agency (EPA) is a good source of information on how that agency's regulations affect small business and ways in which small businesses can satisfy EPA regulations at the lowest possible cost. See

http://www.epa.gov/smallbusiness/

for more information.

In Missouri, the soap manufacturing industry is subject to regulations regarding a number of environmental issues:

- Wastewater: Pretreatment of wastewater may be required when it is discharged to municipal sewers. Pretreatment of wastewater may also be required before its discharge into lagoons specifically constructed for such disposal.
- Air Emissions: Firms that create air emissions (e.g., through spray-drying methods or packaging processes) are subject to permitting standards.
- Storm Water Runoff: Because soap and detergent manufacturers are in the same general industrial classification as chemical manufacturers, they must obtain a permit for rain and snow melt that runs off of their facilities.
- Hazardous Wastes: Proper permitting is required for such wastes.

Generally speaking, a key factor in successfully and efficiently complying with state and federal regulations governing the environment and employee compensation and safety issues is familiarity with such regulations on the part of business owners and managers. While gaining such familiarity can be quite time consuming for small business owners who must serve their firms in many capacities, it is imperative that sufficient time be devoted to keeping up to date with regulatory enforcement practices. The information cited here can help begin that process.

One step that state and local governments can take to help attract and retain businesses is to make sure that broadly written regulations do not have perverse effects on small businesses that do not greatly resemble the majority of businesses in a specific industry classification. For example, Missouri labor safety rules place all soap makers in the same category regardless of the materials and ingredients actually used by firms. Producers using all natural ingredients that pose no danger to workers must pay the same worker compensation insurance rates levied on large producers who use more dangerous chemicals in the soap production process. To the extent that neighboring states tailor their regulations to more closely match the potential danger to workers, Missouri would be a less desirable location for a new or expanded production facility. While we would not suggest that any state should loosen regulations, regardless of the resulting health and safety effects, merely to attract businesses, it does not seem unreasonable to create a regulatory environment based on a rational assessment of possible risks. Some sage has noted that "one size fits all" should be regarded with the same skepticism as "the check is in the mail," an observation that may very well be applicable to broadly drawn regulatory policies.

7. General Strategic Issues

The profitability of a business depends upon both the overall degree of competition in an industry and the position of the business relative to its rivals. A business has little control over the general degree of competition in its industry but can take strategic actions to position itself favorably relative to its rivals and thereby influence its profitability. Businesses that earn profits above the industry average do so because they find a sustainable competitive advantage. This advantage allows such firms to position themselves relative to their rivals in ways that emphasize their relative strengths; and this in turn allows them to better cope with the various forces of competition.

It is common to distinguish between two broad strategies to achieve competitive advantage. The first is cost leadership, and the second is product differentiation. Each of these strategies represents a different route to sustainable competitive advantage and above-average profitability. Moreover, no matter which of these approaches is adopted, a firm also needs to determine whether it will compete for all buyers in a particular market or focus on just a target segment of the market. Successful firms will choose a strategy and target segment based upon their own individual strengths and weaknesses.

Cost leadership is a strategy of attempting to become the low-cost supplier in the industry. Sources of cost leadership are varied but would include such things as pursuit of scale economies, use of proprietary technology, preferential access to raw materials and other inputs, and specific knowledge of customer needs. Firms pursuing this strategy must seek out all sources of cost advantage while at the same time produce a product that is perceived as comparable to that of rival firms.

In a **differentiation strategy** a business attempts to make itself unique in an industry along dimensions that are considered valuable by buyers. The business needs to find attributes that buyers perceive as important and position itself to meet those needs. The attributes along which differentiation may be achieved are extremely broad, including the product or service itself, the delivery system used, the marketing approach adopted, and so forth. To be successful in a differentiation strategy, a business must choose attributes to emphasize which will allow it to be perceived as distinct from its rivals. Differentiation is often a more promising strategy for products sold to consumers rather than to firms processing them for later sale.

No matter whether cost leadership or product differentiation is pursued, a firm must also decide how broadly over the market it should compete. Most markets contain so-called segments. These segments are distinct customer groups who posses a common set of characteristics or special needs. In consumer goods industries, for example, buyers may be segmented by income levels, frequency of purchase, knowledge of the product, and so forth. Industrial goods buyers may be segmented by size of buyer, willingness to trade price for quality, location, or special product needs. A firm needs to determine whether it will attempt to serve all of the market segments or focus upon target segments.

When a firm focuses it aims to better serve a single or small number of buyer segments in an industry. For some segments this will require a firm to be a low-cost producer. In other segments a firm may compete by offering a differentiated product. Firms that become very narrowly focused (specializing perhaps in as little as one segment with a single product) are often said to be following a “niche strategy.”

By their very nature, small businesses typically must focus on only one or a few segments of an industry. Whether a strategy of low cost or product differentiation is appropriate depends upon the nature of the buyers in the segments being pursued and the positions of rival firms competing for those same buyers. Consider for example the following sets of questions in reference to a particular buyer segment:

1. Are other firms competing in this segment currently utilizing large-scale, low-cost production technologies? The existence of such firms may make it difficult to attract or maintain customers.
2. Are the products or services produced for this segment virtually standardized? Purchases of standardized goods and services are generally made on the basis of price alone.
3. Can the attributes of the product or service and its quality be ascertained by the buyer prior to purchase? Such products can be judged according to acceptability by buyers, and for a given quality a supplier must also offer the lowest price.
4. Are the buyers extremely price sensitive and unwilling to pay much of a premium for enhanced quality or image? In some cases nothing matters other than price. As a result, only firms able to offer the lowest prices are able to survive.
5. Is little post-sale service required for this product? Competition in segments in which post-sale service has little or no significance often will turn on price alone.

If each of these questions is answered affirmatively, then for this particular segment cost leadership is likely to be a dominant strategy. Segments displaying these characteristics offer little scope for creating value to buyers through differentiation efforts. Successful firms will be those who manage to achieve minimum cost in serving this type of target segment.

Product differentiation becomes a more viable strategy in segments where the conditions given in questions (2.) through (5.) above do not prevail. Under these circumstances, firms have the opportunity to offer differentiated products or services with attributes that are especially desired by buyers. Firms successful in product differentiation benefit through the ability to obtain price premiums for their products.

Small soap producers are more likely to be selling consumer goods, which makes differentiation an attractive strategy. As previously discussed, the market for natural soaps is growing rapidly. This suggests that one possible approach for small soap makers would be to specialize in serving the narrow soap segment defined by consumers who purchase natural soap products through health food stores and their Web sites.

8. Challenges

In the previous sections of this report we have discussed some issues that soap makers, particularly smaller firms, are now or will soon have to confront in order to maintain successful businesses. While these issues are not generally unique to the soap industry, they certainly affect soap makers. We will summarize those issues here, casting them as challenges to be met.

One important challenge is making a smooth transition to electronic commerce. Even if a firm has no plans to sell directly to consumers over the Internet, it will almost certainly have an increasing volume of electronic transactions with its suppliers and with the retailers to whom it sells. While in many ways electronic commerce is simply old tasks performed in new ways, it nevertheless requires a different set of skills to carry out successfully. One important shift in traditional thinking involves the speed of change in electronic commerce. The techniques and technologies employed to conduct such transactions are constantly changing, which requires firms employing these methods (every firm, eventually) to be more nimble and to react more quickly. In addition, the increasing importance of electronic commerce will require the hiring of people, either directly into the firm or as major consultants, who have skills that were virtually unheard of as few as five years ago. Larger businesses and those in urban areas will likely find such people more easily than small businesses in rural areas. Finally, getting the people they need may require a more active approach on the part of small businesses. Such firms may find it worthwhile to approach administrative officials in local secondary and vocational-technical schools and clearly explain what sorts of computer skills potential employees should have.

Another challenge is understanding and following environmental and labor regulations. While many businesses, especially small ones, may view government regulations as major distractions from the main line of business, it is important to understand that familiarization with the rules can pay off in the form of avoided legal fees and fines. Many publications are available both electronically and in print that can help. Furthermore, an active approach to this issue can be useful. In a previous section we cited the example of how an incorrect classification by regulatory authorities can lead to paying a higher worker’s compensation tax bill. Efforts can be made to change the government’s administrative rules to ensure that regulations are appropriate to the firm being regulated.

A final challenge is both related to employee hiring and retention and is likely to affect a variety of industries in addition to the soap industry. Small businesses generally incur higher costs per employee for many of the benefit packages that, in today’s tight labor market, must be offered to keep skilled employees. While many solutions to the health insurance problem in the U.S. are being explored by governments and private firms, no single best answer has emerged. Until the situation changes, it will remain difficult for small businesses to offer competitive benefit packages. Such firms will have to develop ways of retaining employees that are not (entirely) based on compensation, including providing a comfortable work environment and flexible work hours.

9. Topics for Further Research

One of the major problems facing this and a number of other industries is the shortage of workers with the computer skills necessary to facilitate the transition to a business model in which electronic commerce plays an important role. As discussed in the labor market section of this report, training in these fields will in most cases have to be provided by the educational establishment rather than the firms themselves. It would be of great assistance to both economic developers and the designers of educational programs to know what computer skills are in the greatest demand and what kinds of secondary and vocational-technical schooling are currently available in Missouri. The geographic distribution of the availability of such training is also critical, since many potential workers may not wish to travel even shorter distances to obtain the training. Further research into this area would ultimately benefit not only the soap making industry, but also any industry that is expected to participate increasingly in electronic commerce—in short, almost every industry.