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INNOVATION POSSIBILITIES IN DISTRIBUTION MANAGEMENT

with special consideration of the conditions in mixed economy developing countries*

by

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1. Introduction:

Whereas marketing management has become a recognized profession in the last fifty years, in Europe particularly since the early fifties, distribution management - by many - is still not considered anything more than a routine which is learned "through practice". While most schools of business administration put heavy emphasis on the qualitative - that is mainly sociological and phychological - and quantitative - that is mainly statistical - aspects of marketing, and graduate masters of business administration and Ph.D's in management whose thesis deal with such subjects as "the marketing of refrigerators through mailorder houses in the US" or "forecasting consumer expectations regarding car purchases" or simply "the planning of advertising media", much fewer institutions cover the specific subject of distribution, i.e. wholesaling and retailing. Among the academic institutions concerned with the subject is the University of New York, where a masters degree in supermarketing can be obtained, Michigan State University, which counts among its achievements a series of distribution studies for agricultural products in selected Latin American regions or in Western Germany the Institute for Distribution Research of the University of Cologne and its equivalent at the University of Saarbrücken.

In spite of these examples, the ratio of university-educated marketing specialists against distribution specialists may still be 20:1 or even 50:1. Although substantial contacts in this area exist, a recent attempt to obtain the services of one such specialist to go as a single expert to a Latin American country which is considered among the very attractice choices for such an assignment, Mexico, was unsuccessful in Austria (even though at least twelve persons were contacted).

One would even have considered non-Spanish-speaking people. Only by coincidence a professor was found in the Federal Republic of Germany who had worked on the subject intensely before and who managed to obtain a leave-of-absence from his school for that purpose.

The following observations are based on studies in developing and industrialized countries, mainly of the mixed economy and market economy types. Problems are observed everywhere but in varying degrees. There appears to be an almost perfect correlation between the degree of industrialization of a country and the state of its distribution system, so much so that one is tempted to invert the normal assumption: "Industrial Development brings about a Modernization of the Distribution System" into "Modern Distribution Systems accelerate and shape Industrial Development."

2. The Condition of Distribution:

a) Direct Observation of Facts:

The explosive development of cities in most countries has resulted in a dramatic problem of food supply to urban populations. Often, the prices paid to the farmer are increased five- and ten-fold in city shops. Where price regulation takes place, the regulated products are not offered any more and an outcry is heard against the intermediaries, who enrich themselves, who exploit the economically weak, etc. In many cases - with the exception where particularly vicious groups of intermediaries are proven to resort to illegal practices - it is overlooked, that if the trade was really so profitable, more and more people could enter it and participate in the "exploitation" process. The fact is, that many intermediaries are coping with great difficulties themselves. They incur high costs when they travel (as truckers) from subsistence farm to subsistence farm to collect small quantities of products of varying types, sizes and quality (freshness), then spend the day

on the road to the city to sell their products to equally small wholesalers or to retailers at the current market rate in competition to farmers from nearby who sell directly. They face substantial losses when they purchase perishable products as wholesalers from the truckers and cannot sell them the same day since they do not have adequate storage facilities. They have to accommodate themselves in cheap locations as retailers with no space to store the products, to keep an assortment in stores which often measure less than the size of a living room. It is obvious, that the rule of the trade is to purchase at the lowest possible price and to sell at the highest possible price. Most intermediaries in developing countries barely subsist on the difference because of low volumes, negative profit margins on price-regulated items and high losses of merchandize.

A very recent survey of the situation of the retailer in a metropolitan area brings out the following observations with regard to retailers:

i) Small retailers are selling products (mainly food) at higher prices than supermarkets since they also pay high prices for their small volume purchases, since they are operating on minimum surfaces (less than 30 m2) and since many of their products decay rapidly. A retailer may have up to 60 suppliers for 100 products he sells and be visited daily by half a dozen salesmen or more. Also, some of the products he must pick up from the market himself.

ii) Small retailers are often situated in private houses, the conditions of which are not suitable for the sale of food - or other products. The quality of merchandize, particularly with regard to the perishable products, leaves much to be desired.

iii) Retailers cannot offer their clients continuously the same

assortment as their size makes it necessary to store only minimum quantities. The number of times, when a retailer is found out of stock dramatically increases with the decrease of store size, even though the assortment of the smaller store is more restricted from the beginning.

iv) Apart from not offering much comfort to the consumer by making products easily accessible or by providing an attractive appearance, small shops often also do not display much courtesy in dealing with the consumer.

It is further stated in the report quoted, that these retailers are responsible for 75% of the food sales to the consumer in that city and that in particular the poor parts of the population are dependent upon them.

The situation is typical for most cities in developing countries.

b) Opinions encountered:

Starting with the urban consumer, who sees in front of him the choice between the purchase in the small shop and the attraction of the large supermarket, he often presumes behind both a network of intermediaries in the country, who monopolize food products by extorting the farmer to give them cheap prices and subsequently hoarding these products to achieve maximum prices in the cities.

Certain cases of extortion of farmers exist, often created by some sort of long-term dependency on the basis of loans or supply agreements; also so-called protection rackets have been observed. However, such observations apply mainly with regard to specific products, never with regard to the supply of food or other consumer goods in general. In view of the political sensitivity of the issue, Governments have fought such practices through price control, drastic

punishment or by opening the frontiers to cheap imports of such items. Meat, eggs, but also certain staple products have been subject to such practices. Sometimes, such networks of intermediaries are so well organized that they supply the consumer - who would otherwise bear the high cost of an "atomized" system - with impressively low prices - as was observed in connection with the meat trade in a Latin American country. With few exceptions, high consumer prices are a consequence of inefficiency, not of occasional examples of supply control.

One of the reasons of such deficiency may be seen in another general opinion held by the public of many countries: That distribution or activities related to trade in general, are socially questionable and, therefore, a matter for the lower social classes or the immigrant minorities. This attitude must have deep cultural roots in all of our societies. It might be an interesting subject for a thesis to look back into our most ancient literature for examples of open discrimination of the trading professions. Is retailing a socially desirable profession today?

Such prejudice is accompanied by a complete misunderstanding of the productive function of the trade, the concept that a product does have different values depending on the convenience with which it can be obtained. The value of a potato in the field is simply not the same as a potato in the supermarket next door, clean and packed in a net, assorted with others of similar size and available almost any time, along with other goods which are bought at the same occasion in an attractive environment with courteous treatment. The inherent value of the potato here consists of the effort of nature and the farmer plus the many other efforts invested into cleaning, grading, packing, transporting, storing, transporting, exhibiting and the various modules related to the flow of money in the opposite direction.

One of the current misconceptions about this process is the

accentuated value attributed to whatever is seen as production and the psychologically diminished value of the intangible aspect of distribution. Here are even bigger productivity reserves than in production, here much of the production effort is wasted in deficient systems.

Government employees are normally victim of the general popular prejudices and misconceptions. They compare the prices of the farm to the prices to the consumer, see the intermediaries floating in between and declare these en bloc culprits of what is the natural consequence of the rural exodus - urban migration problem, a dramatic increase in food prices. The call for price controls to calm the unrestful city dweller and to help the urban poor is accompanied by an outspoken hostility against the intermediaries (mainly the wholesalers) which one wants to eliminate in order to "solve" the problem.

It is overlooked that where such intermediaries are non-existent, industry resorts to direct distribution to retailers - with the consumer bearing the cost. In one country, a dairy products manufacturer employed 300 salesmen to serve a market of 10 million people, a chocolate and chips manufacturer maintained 400 people with small cars plus trucks plus 9 refrigerated depots just for its own products in the same country.

It is further overlooked that integrated distribution systems - where the retailing and wholesaling function is co-ordinated by the same hand - are not only much more economical than "atomized" systems with a few wholesalers mingled in between, but that they have the further advantages of reducing consumer prices and increasing supplier prices, provided they compete with each other. Not only do they reduce the cost of transportation and storage, they also reduce the sales forces of manufacturers to a minimum (much fewer calls are required). Furthermore, they have an educational influence on the

suppliers in imposing ever increasing quality standards, while facilitating price reductions through their effort on cost degression on all levels, particularly also on the manufacturing level.

Such integrated systems in industrialized countries are operated by consumer co-operatives, retailer co-operatives, wholesaler/retailer chains, private firms and the public sector. Independently of ownership, they all apply approximately the same procedures, their indices for sales per employee (wholesale or retail) per sqm, per cash register, for stock turnover, etc. all not too far apart. Their degree of service varies with small variations in prices. All give special offers, all see to it that they can always present the consumer with the full assortment. Since recently in some countries, all endeavour to give special attention to the freshness of their products, often supported by Government legislation to indicate the ultimate date of consumption on the package. Their net margin is in the order of $\frac{1}{2}$-1$\frac{1}{2}$%. In other words, if forced to lower their prices on the average by 2%, these highly efficient systems would start to lose money.

Government officials, unaware of these facts, tend to include such integrated systems into their suspicion against intermediaries. Sometimes they feel they should be replaced by markets where the consumer has a "direct" access to the supplier, sometimes they nationalize these chains, sometimes they open Government shops alongside with these systems.

They not only overlook the complexity of the know-how involved in managing such intangibles for which Government civil servants are by their education often extremely ill-prepared, they also overlook the tremendous cost of the system since they do not calculate the

time of the persons involved, the cost of space (which is often comparable to all of the investment in the manufacturing industry combined) or the cost of transportation, sorting, redistributing, etc.

In one country, the Government wanted to prove it could sell more cheaply than the private trade by opening a fruit shop in an urban market. It retained a small profit while selling 10% more cheaply than the private firms. Only, the salaries of the attendants and the cost of the store itself did not enter into the calculation.

More often - and this now applies to the public world-wide, the social cost of the consumers' inconvenience is fully overlooked in the logistics of distribution. Certain officials feel, that offering products of low prices - independent of quality, distance of shop, shopping convenience and atmosphere - is sufficient. A recent thesis on the subject in Austria identified the conveniences of reaching a shop easily, of finding a full assortment under one roof and the pleasure of doing one's purchasing in a friendly, hygienic and uncrowded environment as true values.

With varying emphasis - according mainly to the family status and depending upon their occupation, consumers have shown an interest in all the aspects mentioned above. Housewives with children were more interested in being able to buy everything under one roof at one opportunity. They wanted to reduce the workload of shopping to a minimum. Women in other professions were not so much concerned with that convenience and more inclined to shop around, although again in fairly concentrated shopping districts.

It has been argued, that poor consumers will be interested only in low prices and walk long distances if they can find the basic product of their daily diet 10% cheaper. This is not so. Only when the basic product is not available elsewhere, special trips - which often also cost money in public transportation apart from time and other

sacrifices - will be made. The experience of some Governments, which create parallel channels of distribution just for basic products, is often economically most doubtful if other alternatives of action are taken into consideration (such as rationing systems, subsidy systems, etc.).

The consumer - who normally is extremely passive with regard to voicing an opinion on such services as retailing (or other) is the most neglected entity in the process of distribution of which he is - possibly - the most active member of the chain if one considers the workload of shopping of the average housewife. One of the current misconceptions in this connection is, that shopping is altogether a pleasurable activity and should, therefore, not be considered as work. Here we find a combination of two misconceptions. The truth is:

- shopping has been found to be pleasurable only for certain products at certain occasions;
- work does not have to be unpleasant to be valued as such.

An economic community, which wants to improve its system, must take an integrated look at the subject, including the consumer whose time and transportation could even be assessed in terms of real cost (apart from such less tangible elements of atmosphere, personal attention, easy orientation, etc.).

3. Opportunities of Innovation:

Innovation here is not seen in an absolute sense but related to the specific economic environment. It must take into account the degree of urbanization, the availability of food products from local and foreign sources, the degree of industrialization (in particular food processing and packaging), existing investments in the distribution infrastructure, the income level and the distribution of national income by income

classes, the degree of unemployment, the mobility of the consumer (amount and types of private and public transportation media available), his storage facilities (in particular refrigerators), marketing and consumption habits, the climate, the role of women and children in society, etc.

However, there are certain basic facts to be retained, along which one should orient one's search for an optimal system - a system which will give the greatest degree of satisfaction in the long run at a given socio-economic cost (including such elements as investments in infrastructure and valuing the daily chores of the consumer). It is obvious, that in a changing society this optimum will continuously change:

a) There will be an optimum amount of intermediaries in any situation with the exception where it is really more economical to buy from the farmer. This optimum must be determined. It is not identical to the minimum. In many industrialized countries we normally see three levels of intermediaries: the national (bulk purchasing and importing) level, the regional level for intermediate storage and reassembling of deliveries and the local level for retailing. If one adds the storage and delivery functions of the producer and the purveying and storage function of the consumer - the two extreme points of the system - one has de facto five levels. If the system is optimized, any shorter connection will increase the socio-economic cost. This is the case when manufacturers travel with relatively small individual orders to ensure that retailers always offer <u>their</u> assortment. Another apparent short-cut, the mail order system, is really nothing but a parallel scheme as the function of storage and reassembly at the regional level is taken by the post office - which may or may not use idle capacity for this purpose.

b) Innovative effort can also start with a close look at the consumer purchasing habits - or even habits which the consumer will find economically opportune to develop. Thus, the idea of buying everything under one roof implies a relatively high overall distribution cost, since ever increasing assorments of articles must be kept in store (up to 7000 now in supermarkets). One therefore observes the development of integrated discounter systems where a rigidly controlled assortment of 300-400 products is sold at very low prices and where the consumer then complements his purchases of day-to-day requirements in smaller shops, markets or even supermarkets. It is of interest to study whether weekly or even monthly purchases are attractive to the consumer who must have access to the respective sources (through his own vehicle, adequate public transport or home delivery) and who must have some storage capacity. In some countries, there is even a requirement for improving his financial capacity before a consumer can start purchasing in bulk.

c) A third area for innovation, perhaps the most important one, is the relationship between producers and intermediaries. Direct supply from manufacturer to retailer has been identified as a less than optimal method. The disadvantage of a producer dealing directly with many small stores lies furthermore with his capacity to dictate his conditions to the latter. A small shop cannot efficiently challenge the producer to supply better quality or lower-priced articles. Large integrated systems can do this - and in fact do. They often have their quality control laboratories and are expert enough to assess the manufacturing costs of their suppliers. Competition in such terms as quality and price between producers and between national (or regional) purchasing offices leads to a continuous and steady improvement of industrial - or agricultural - supply.

Such competition does not have to exclude master contract type arrangements, where certain suppliers are given a guarantee of purchase for a certain quantity of product to be delievered according to predetermined quality standards and prices during a certain period. Such master contracts permit long-term planning but do not give blank cheques for a long-term relationship between the market partners, if either partner becomes dissatisfied.

Such systems can gradually improve the quality of national suppliers and lift the offer to standards required for successful exporting efforts.

4. Innovation Method:

Innovation will start from an integrated look at the distribution system how it should be and evolve in the future. It will then be found that the following instruments could be used by the interested Government and other competent national bodies:

a) Legislative measures to facilitate the co-operation of consumers, retailers and wholesalers for the purpose of forming competing integrated systems.

b) Legislative measures which ensure cheap and convenient supply of basic products to economically weak groups. If - in response to such needs - the Government wants to set up a parallel distribution system, it must be aware of the cost of the proposition and the real effect it will have on the consumer and the existing system.

c) Institutional measures to set up adequate training facilities for distributors on all levels - including the universities.

d) Institutional measures to assist distributors through efficient consultancy in such questions as store location, store design, the handling of fresh products, the available systems of inventory control, how to schedule transportation, how to facilitate the picking of orders in warehouses, etc.

e) Institutional measures to create financing facilities for modernization.

f) Communication measures through issuance of newsletters and specialized magazines to discuss technological innovation in all aspects related to distribution.

g) Public relations measures to create a collective awareness of existing problems - through symposia, conferences, etc. - and to work against certain prejudices and misconceptions as mentioned before.

5. Main Obstacles to Innovation:

Normal inertia combined with a lack of concept of the macro-economic importance of the distribution function and a lack of vision for the potential benefit which can be derived for the entire economy - in particular the national industry - from its improvement, are at the root of most arguments, which are set against its change:

a) Re-educating old-fashioned shopowners is seen as difficult.

- The solution to this is directing the effort towards the next generation.

b) The young generation does not want to stay in retailing or wholesaling as it wants to improve its status.

- The solution to this is raising the status of the profession through public events dealing with innovation in that field, etc.

c) The sector is seen as unimportant.

- The solution to this may be a close look at employment statistics, a calculation of the sqm of space required per capita (and for the nation) on retail, wholesale or regional and national levels and to calculate their cost, a look at the capital bound by distribution if stock turnover is four

times rather than 24 times per year, a look at the wastage experienced through inefficiency, etc.

d) The distributors are seen as uninteresting partners for national development efforts as they normally do not have a high level of education and as they do not perform a "productive" function.

- The solution to this may be international system comparisons, which may stimulate efforts in the direction of lifting the level of education in that area. Such education may also lead to a better recognition of the productive value of improving the national infrastructure of distribution.

e) Improving distribution is not seen to have much of an impact on the manufacturing activities.

- A world-wide look at countries with modern distribution systems will yield a close relationship between these and industrial and economic development.

f) Improving the distribution system will lead to unemployment.

- It is true that in weak economies with low volumes of distribution, approximately the same share of the population is occupied in distribution as in strong economies. Furthermore, it is true that much hidden unemployment is covered up by a chaotic distribution situation. However, the solution to unemployment is reemployment and in the modernization effort itself (construction, packaging, manufacturing activities), there will be ample room for reemploying those who are now living off the high price of products paid by consumers. It must be remembered that many of them generate their living through the performance of unnecessary activities (such as imposing additional products on small shops) and that this expenditure is paid by society which does have no long-term

nor even short-term benefits from many of these. With only some upward adjustment of the income of these persons, stores could be modernized, refrigerators built, products packaged for protection against shock, infection, etc.

g) The modernization will require huge funds.

- If funds have to be raised for the purpose of long-term infrastructural investments, this is often done through increasing the public debt to domestic and foreign banks. To modernize the distribution system, practically only local funds will be needed.

  In addition to this, the generation of such activities which are required to undertake such modernization, will stimulate other economic activities.

  It is likely, that the overall economic situation may be stimulated not only by the end result of the effort but by the process of modernization itself.

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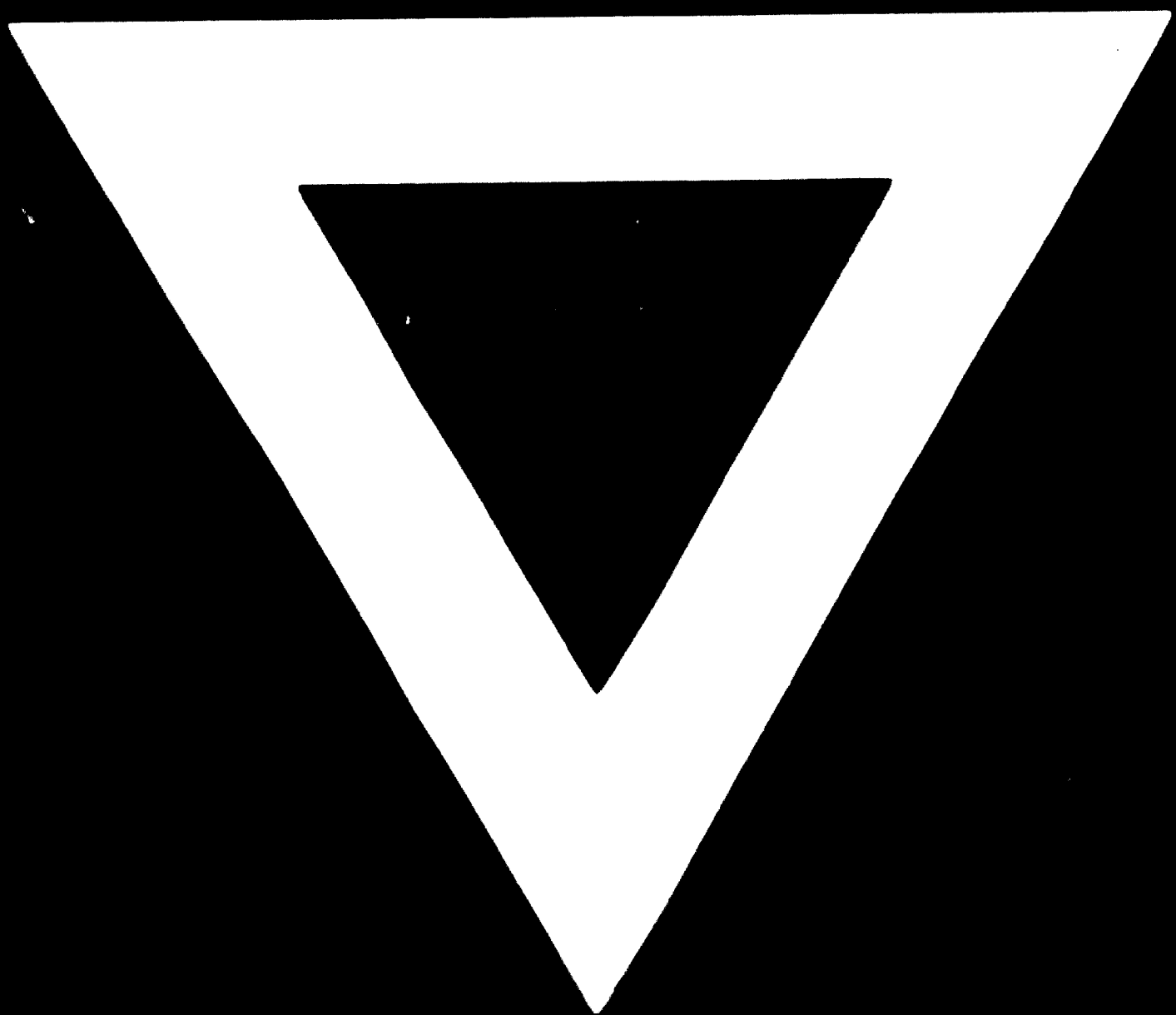

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