CHAPTER 4

ANALYSIS OF RESULTS

This chapter presents the findings gathered in the survey. It comprises a presentation of the importance of distribution channels, as compared to other marketing variables, the distribution channels of cement and steel bars manufacturers, the extent of government influence, the reasons for channels, the functions of channel members, criteria for selection of middlemen, and motivation of channel members.

4.1 Importance of Distribution Channels

The study found that cement manufacturing companies produce cement of a quality that is much higher than the required Malaysian Standard (M.S.) set by SIRIM. The same applied to steel bars manufacturers, producing steel bars to required Malaysian Standard (M.S.).

Most manufacturers of cement and steel bars interviewed claimed that their customers have a significant preference for their brand. Reasons cited include better product quality (i.e., above Malaysian Standard) and better service.

However, the results of the survey clearly show that consumers will not hesitate to substitute a brand with that of any competitor's should a particular brand be not available. This indicates clearly that there is no brand preference among users of cement and steel bars.

Although cement and steel bar manufacturers interviewed claimed to conduct promotion activities, further probing with more specific questions revealed that promotion activities did not go further than building better personal relationships with middlemen. Most manufacturers agreed that promotion for their product brand is not necessary as their product can be easily substituted with competitors' brand.

The survey also revealed that the manufacturers of cement and steel bars are aware that end-users normally do not specify the brand of cement or steel bars they required. End-users will only state the quantities of cement and steel bars required in their purchase order when placing an order with manufacturers' middlemen. Most manufacturers of cement and steel bars agreed that the reason for doing so is that both cement and steel bars are homogeneous products.

Manufacturers interviewed indicated that they sell at the same price to their middlemen as both cement and steel bar prices are government controlled. There is no categorisation of middlemen. As far as pricing is concerned, middlemen, or commonly called distributors, are all treated equal, irrespective of their volume of sales generated. These middlemen enjoyed a fixed commission from the manufacturers of cement and steel bars. The middlemen in turn sell at a fixed price to end-users. Therefore, manufacturers dictate the selling price of both the cement and steel bars. Middlemen will have to compete for sales based on their financial abilities in granting credit to end-users. Most of the end-users are contractors.

On the other hand, according to the manufacturers of cement and steel bars, there are middlemen who are willing to undercut price to in order to secure sales. In doing so, these middlemen sacrifice part of their commission granted by the manufacturers of cement and steel bars. However, such practice are not widespread. Manufacturers of cement and steel bars clearly expressed that they do not support such price cutting practices and do not subsidise for such price undercutting.

Thus, manufacturers of cement and steel bars produce products of compatibly high quality (product quality); end-users show no brand preference and are willing to substitute a brand with any competitor's with minimal promotion activities requirements (promotion); and the prices of cement and steel bars as government controlled items are fixed (price). Hence, manufacturers place equal emphasis on each of the marketing variables of product, promotion and price. The remaining group of variables in the marketing mix is place. Place stands for company activities that make the product available to target consumers (Kotler and Armstrong 1991). Placing of products involves distribution channels. As this is the only group of marketing variables available to manufacturers of cement and steel bars, the importance of distribution channels is obvious. Manufacturers with better distribution channels will have a competitive advantage over their competitors. Distribution channels can thus be the potent tool for manufacturers in demand creation and should not be overlooked.

4.2 Distribution Channels of Cement and Steel Bars Manufacturers

Of the five cement manufacturers interviewed, four of the manufacturers have only one plant (one in Perlis, one in Kedah and two in Perak), and the remaining manufacturer has two plants (one in Perak and the other in Selangor). Five of the cement plants are located in the Northern Region (comprising Perlis, Kedah, Pulau Pinang and Perak). Only one is located in the Central Region (comprising of Selangor and Negeri Sembilan).

The five steel bars manufacturers have one mill each. The location of the mills are one in the Southern Region (comprising of Johor and Malacca), one in the Central

Region and all the remaining three mills in the Northern Region. There are no cement plants or steel mills in the East Coast Region (comprising Kelantan, Trengganu and Pahang).

For both cement and steel bars, the survey results show that the Central Region commands the largest market share, followed by the Northern and Southern Regions. The East Coast Region comprises only a small share of the market.

Most of the manufacturing companies of cement and steel bars preferred to sell to the region nearest to the location of their factory. The reasons given were the lower transportation costs and logistic reasons. With retailed price under government controlled, lower transportation costs mean better contributions for sales to location near the production facilities. For manufacturers whose factories are not located in the Central Region, they still prefer to supply their products to the Central Region due to the huge demand in this region. Therefore, manufacturers having their production facilities in the Central Region will have an obvious advantage in terms of location. This could partially explain why no production facilities are located in the East Coast Region.

Irrespective of the location of the manufacturers production facilities, the survey results show that most manufacturers of cement and steel bars manufacturers have their largest sales volume in the Central Region, followed by the region near the vicinity of their production facilities. Correspondingly, most manufacturers of cement and steel bars have the largest appointed number of middlemen in this Central Region.

Among the steel bar manufacturers, there is an undeclared close understanding on overall market shares, as well as regional market shares for each region. Hence, the question of avoiding supply to the least preferred regions does not exist. For cement manufacturers, the same understanding exists, although the understanding is not as close. Nevertheless, cement manufacturers will fulfill all orders even to the least preferred regions. However, these cement manufacturers will try to avoid those least preferred regions.

The survey results show that manufacturers of cement and steel bars do not trade directly with end-users. Most of the cement and steel bars produced by manufacturers are sold through middlemen, commonly known as distributors. In other words, these manufacturers do not sell direct to end-users. In addition, only a minimal amount of their sales goes through more than two channels; most manufacturers cited a figure of less than 5%. This is consistent with the literature survey on distribution channels that intermediate or industrial distribution channel rarely goes beyond two channel levels.

4.3 Government Influence on Distribution Channels

The survey results show that both the products are government controlled items. This means that the Domestic Trade and Consumer Affairs Ministry of Malaysia monitors closely market demand and the production capacities of cement plants and steel mills in the country. Cement and steel bars as government controlled items also mean that all activities pertaining to production, trading, distribution and storage will require licensing from the Domestic Trade and Consumer Affairs Ministry. In addition, as controlled items, the prices of cement and steel bars cannot be retailed at a price higher than the government controlled price. The permissible retail price of each 50-kg. bag of cement in every districts in Peninsular Malaysia is set by the government. As for steel bars, the government has set a uniform retail price throughout Peninsular Malaysia irrespective of the delivery location. According to the manufacturers, the controlled price is necessary to curb overpricing by middlemen especially in times of shortage.

However, the control of official retail prices to curb middlemen from overpricing may backfire. In times of shortage of supply, 'black marketing' exists. Manufacturers claimed that they still sell at the normal price to middlemen as manufacturers are under the close scrutiny of government enforcement officials. Middlemen with their allocations of cement and steel bars do not sell at approved retail price during shortage time. They sell at a much higher price to end-users. The large number of middlemen may make it difficult for government officials to monitor their activities.

In surplus situations, middlemen will pressure manufacturers to lower price if manufacturers want orders from them, again bearing in mind that middlemen carry many competing agencies. Manufacturers proclaimed that price war is a norm rather than an exception in times of supply surplus. This constitutes loss of control to a great extent on their distribution channels.

The strong influence on manufacturers exerted by the government on production, trading, distribution and storage will ensure supplies of cement and steel bars go to every region in the country. This is necessary to ensure that even isolated regions are not deprived of the supplies of the two most essential products for development. This assurance of availability of goods is marred by the need of end-users to pay at a price higher than international market price, which the manufacturers admitted in their replies during the survey.

In general, most manufacturers covered in the survey are pleased that their products are classified as government controlled items. According to the manufacturers, this provided them protection against dumping by foreign manufacturers. Furthermore, the controlled price will ensure a reasonable returns on their investments; as both cement plants and steel mills require huge capital investments in the tune of hundreds of millions of Ringgit. Without such protection, many manufacturers are doubtful whether there are any willing investors in this capital intensive industry.

Furthermore, end-users need not bear the risk of any unexpected fluctuations of price. Manufacturers claimed that this in turn can assist in the price stabilisation of end products of cement and steel bars. This helps in keeping the inflation rate of the two products low. This is important as both these products form the basic raw materials of the building and construction sector in Malaysia.

Strong government control and influence do have its disadvantages. Manufacturers want government protection against dumping. However, at the same time, manufacturers want flexibility in pricing. Manufacturers argued that they are unable to change prices according to local market forces. The continuous spiraling production costs especially in view of the current tight labour market and the escalation of imported raw materials cost have greatly affected the profitability of manufacturers.

Several manufacturers highlighted another disadvantage of strict government control is the inability of manufacturers to export. These manufacturers production facilities are situated in the vicinity of port facilities to facilitate the exporting of the output. Export prices may be lower than domestic selling price. But, because of the location of the production facilities, it is more profitable to export than to sell domestically after taking into consideration land transport and handling charges for domestic sales, the manufacturers argued. However, these manufacturers are not allow to export due to the current situation of demand exceeding supply.

In addition, some manufacturers pointed out that the protection provided can result in complacency on the part of the manufacturers. Manufacturers become less cost conscious-minded on important aspect such as productivity, cost control and quality. This is unhealthy for the long-term growth of the industry as a whole.

4.4 The Need for Distribution Channels

Many reasons were given by manufacturers of cement and steel bars for the need for middlemen. The reasons can be grouped under manpower requirements, market coverage, number of contacts required, and credit risk taking.

Currently, manufacturers have only a handful of sales and marketing personnel. If no middleman was appointed, manufacturers will have to keep track of all ongoing construction projects, as well as to service every end-user in every geographical areas all by themselves. Middlemen are needed to perform these tasks. Therefore, middlemen are appointed to greatly reduce the size of manufacturer's own sales and marketing team. Hence, appointment of middlemen greatly reduce the manpower requirements.

According to manufacturers, it is not possible for their small number of sales and marketing personnel to completely cover the whole market. Manufacturers need middlemen in every geographical area for complete and effective market coverage.

Manufacturers explained that the use of middlemen greatly improves efficiency in making cement and steel bars available to end-users. Consider an example of five cement manufacturers using direct marketing to reach five end-users. Each manufacturer needs five contacts to reach all the five end-users. This system requires twenty-five contacts for all manufacturers to reach every end-user. Consider now, the five manufacturers working through one distributor, who contacts the five end-users. This system requires five contacts from manufacturers to the middlemen, and another five contacts for the middleman to reach all five end-users, giving a total of only ten contacts. As can be seen here, middlemen can therefore, provide cost savings not only to manufacturers but also to end-users.

The use of middlemen reduces the amount of work that must be done by both the manufacturers and end-users through a much reduced number of contacts required. Many of the manufacturers interviewed elaborated that contacts here refer to coordination works with end-users, the number of transactions required to get their products to end-users and the number of trading accounts needed to be serviced.

Production facilities of cement and steel bars usually involve huge capital investments. Therefore, manufacturers do not want to carry the high risk of granting credit to end-users. Thus, middlemen are needed to carry the inherently high credit risk in trading with end-users of cement and steel bars. End-users for these products are mostly contractors. According to manufacturers, middlemen are mostly established firms with strong financial background, and therefore, have much less credit risk. Moreover, by going through middlemen, the number of accounts to service is fewer, making control of accounts easier.

Most manufacturers claimed that middlemen can produce more effective sales than manufacturers themselves. Middlemen have an assortment of building materials needed by end-users. Therefore, middlemen can provide a package deal to end-users making their sales effort more effective.

To sum up, for both cement and steel bar manufacturers, cost consideration is cited as the main reason for the need for distribution channels. It is not feasible for manufacturers to have their sales teams which carry only one product to cover every consumer in all the regions. The cost incurred will be too high. For the middlemen, they are different because they also carry an assortment of other building materials required by the same end users.

4.5 The Functions of Distribution Channel Members

The findings revealed that the three important functions of distribution channel members most often mentioned are:

- Risk taking - that is assuming the risk of carrying out the channel work including granting credit facilities to consumers,

- Financing - that is acquiring and using funds to cover cost of channel works, and

- Matching - that is to help shape and fit consumers' need.

The other functions of distribution channel members mentioned by manufacturers of cement and steel bars include gathering and distributing of information in the marketing environment, carrying out promotional activities, finding and communicating with prospective buyers, and negotiating an agreement on price and other terms of offer. According to the manufacturers, promotional activity of middlemen mentioned above is limited to spreading persuasive communications to end-users about the manufacturers.

The findings also revealed that most distribution channel members of cement and steel bars are not involved in the physical distribution of the goods. Transportation, inventory carrying and warehousing of goods are carried out by the manufacturers of cement and steel bars themselves.

4.6 Selection of Channel Members

The survey found that middlemen can be categorised as national middlemen, regional middlemen and localised middlemen. National middlemen or national distributors are middlemen having sales offices in all strategic locations throughout Malaysia. Regional middlemen are those having sales offices only in their region of operation, while, localised middlemen or commonly referred to as preferred dealers have only one sales office of operation.

Most mnufacturers of cement and steel bars have the ability to attract qualified middlemen. Both manufacturers of cement and steel bars, therefore, have no problems in signing and selecting the best middlemen they want. This is because cement and steel bars being the two basic materials for the building and construction sector are the 'bread and butter' for these middlemen in this trade. Without these two basic products, middlemen will have difficulties in selling other more profitable building materials to end-users.

There are no restrictions on the number of competing agencies middlemen can carry. For example, a middleman having Associated Pan Malayan Cement (APMC) distributorship, may also be a distributor of Cement Industries Malaysia (CIMA) and Perak Hanjoong Cement. Similarly, middleman having the distributorship of Amalgamated Steel Mill (ASM), can also have the agencies of Malayawata and Perwaja. In fact, most of the middlemen carry three or more competing agencies. According to the manufacturers of steel bars, the number of steel bar distributorships a middleman carries is an indication of his sales performance. This is because other steel bar manufacturers will also want to appoint performing middlemen as their distributors. Further probing with questions revealed that steel bar manufacturers want to compete within the same middlemen that carry competitors' agencies. Manufacturers of cement on the other hand, appoint middlemen differently. In most circumstances, manufacturers of cement are reluctant to appoint a middleman as distributor if that middleman is already a distributor of competitor. In this way, cement manufacturers hope for stronger middleman selling support, and for better control of credit granted to each middleman.

Manufacturers also pointed out that many middlemen carry more than one competing agencies so as to avoid dependence on one source of supply. A situation in which demand exceeds supply is not uncommon. Occasionally, there are also shortages of certain sizes of steel bars. As one brand is easily substituted with competitor's, middlemen sought as many agencies as possible. One manufacturer puts it as middlemen's 'double insurance policy' to ensure uninterrupted supply.

Another reason for middlemen to have many competing agencies is to have more credit facilities. Manufacturers grant a limited credit facilities to each middleman, and are very strict on credit control. Middlemen are not allow any more goods once the credit limit is up. By having accounts with as many manufacturers as possible, the middlemen will then have more credit facilities. For example, middleman A is granted RM 10,000.00 credit limit by cement manufacturer A. Once middleman A's total outstanding has reached that amount, no more goods are allowed. However, if middleman A carries the agencies of all the five cement agencies, and assuming each cement manufacturer grant him RM 10,000.00, then he now enjoyed a credit facilities of RM 50,000.00.

Middlemen do not carry stock for the manufacturers. As mentioned earlier, middlemen only enjoyed a fixed commission from manufacturers, and this commission is small compared with commission for other non-cement and non-steel bars products. Value to weight ratios of both the cement and steel bars are low compared to many other building materials. Low value-weight ratios have high transportation costs as a percentage of sales. This is one of the reasons why middlemen do not carry stock for these two products, as keeping stock involves double handling which is expensive. Moreover, manufacturers in the survey can deliver promptly to end-users upon receipt of purchase order from middlemen. This again eliminates the need for stocking.

In the selection of middlemen, no territorial right is given to any middlemen. They can take orders from consumers in any region and relay the information to the manufacturers for deliveries. Consumers do not normally specify which manufacturers of cement or steel bars they want. Therefore, the relationship of manufacturers with their middlemen is of utmost importance since most middlemen carry more than one agency.

In determining the number of middlemen, the strategy is to provide as wide as possible geographical coverage to assure availability of middlemen in every area. That means the strategy employed in determining the number of middlemen is that of intensive distribution in which products are made available where and when customers want them so as to provide maximum product exposure and end-user convenience.

Although an intensive distribution strategy is employed, this does not mean that all available middlemen willing to carry the manufacturer's product will be selected. Manufacturers do select middlemen carefully based on certain criteria. The potential for growth, number of years in business and reputation of the middlemen are some of the important characteristics that most manufacturers of cement and steel bars sought in the appointment of middlemen. Other characteristics sought by manufacturers of cement and steel bars are size and quality of middlemen's sales teams, middlemen's cooperativeness, their profit record, and competitors' line carried. A few manufacturers claimed that an intensive distribution strategy is selected merely because other manufacturers employ this strategy.

4.7 Motivation of Distribution Channel Members

Most manufacturers of cement and steel bar have no specific approaches in motivating middlemen. Manufacturers elaborated that monetary rewards are not used to motivate middlemen as prices are fixed.

The survey revealed that much of the business is done based on the relationship between the manufacturer's representatives and the middleman's representatives. Manufacturers' representatives make constant and routine visits to middlemen. Lunching and dining together is not uncommon to foster and reinforce the relationship. Such relationships are important since most middleman carry more than one competing agency.

The survey also found that, in addition to the extensive entertainment to develop informal relationships, manufacturers must always strive to provide the best possible services to their middlemen in order to have a competitive edge. These services include providing prompt response to enquiries, prompt solutions to problems solving, prompt delivering services, and ensuring goods are available when needed. In addition, manufacturers must be fair in their allocations of supplies in times of shortages, which occur quite frequently. Other additional service includes assisting middlemen in the closing of orders.

As intensive distribution strategies are employed, termination of an agency of non-performing middlemen is rare. However, many middlemen's agencies were terminated for non-payment rather than non-performance of sales.

The survey found that performance of middlemen are not checked against standards such as sales target, treatment of damaged and lost goods, cooperation in promotional activities and training programs, and services to end-users. This is due to the sensitivity of eventually branding a particular middleman as non-performing. This is important as middlemen decide which manufacturers to supply for a particular order. Moreover, a performing middleman in this quarter may be a non-performer for the next two quarters if the consumers they are serving do not have any project during these periods. Nevertheless, manufacturers do evaluate the performance of their middlemen. Depending on manufacturers concerned, performance reviews of middlemen are done either on a monthly, quarterly or half yearly basis. It was found that the emphasis of performance review is more on credit control purposes rather than on sales performance. However, the performance evaluation is only meant for internal circulation, and is not made known to their middlemen.