CHAPTER 2.0 LITERATURE REVIEW

2.1 Brief Overview Of Distribution System

In many parts of the world, the grocery distribution system has been described as lengthy, complex and characterised by many layers made up of manufacturers, wholesalers, distributors, stockists, agents/jobbers, transporters and finally retailers. On the most past, with the many parties involved within the supply chain, distribution systems have been operationally lacking since prices are generally high, with large volume of stocks in the supply chain pipeline. The practice of forward buying and selling to take advantage of volume purchase pushes excessive inventory into the supply chain leading to cost inefficiency. In some countries, distribution channel inefficiencies have also been caused by the slow evolution of the distribution infrastructure such as transportation, delivery and distribution centres and practices rooted in the past.

However industry players are now waking up to dramatic impact brought on by global & technological factors and the information economy. The industry must be revolutionised to meet challenges within the changing retail landscape.

2.2 Distribution System In Developed Countries

The literature review here is based on researches covered in the United States (US) on the grocery distribution business.

In the US, large stores dominate the grocery retail sector with key retailers purchasing direct from the manufacturers. Replenishments are delivered by the manufacturers or through the distributors or wholesalers that the latter employ. This is to say that manufacturers may sell direct to large retail organisations in the cities without setting up of a comprehensive wholesale organisation by acting on their own distribution management. The retail stores provide an effective distributive outlet for the manufacturers' advertised brands. In the US, the supermarkets and cash and carry outlets are the dominant self-service outlets and they are briefly described as follows (Maureen Guirdham, 1972).

Supermarkets

Supermarkets make up the largest number of self-service outlets. In the self-service stores, the customer selects her purchase from those available on the shelves and in refrigerated cabinets, collects them in a basket and pays for them all together at the checkout. The customer gets a wide range of products and brands clearly presented for her choice, with clearly marked prices. Supermarkets are important outlets for food, toiletries & disposables, pharmaceuticals, wines and spirits, tobacco and cigarettes, other durable household goods such as small electrical appliances.

Cash and Carry Outlets

Cash and carry outlet operation involves cutting prices on the entire range of goods stocked as against the selected cuts offered by most supermarkets. To achieve these price levels, these stores expect their customers to buy in bulk. Other cost-cutting measures include the provision of only minimal in-store fixtures and fitting. For example, many of these warehouse-like stores have no shelves and goods are stacked instead on standard pallets for display. Manufacturers' bulk deliveries are made straight to the stores whose operators thereby cut out the expense of central depots and delivery vehicles. Cash and carry stores' stocking policies reflect the need to achieve a high stock-turn: the range of goods stocked is narrower than in supermarkets and the heaviest discounting is concentrated on the brand leaders. Home delivery and purchase on credit are generally not available hence the term "cash and carry".

Cash and carry stores cater to both the end consumers and the smaller retail grocers. Briefly, for the latter, cash and carry stores provide supplies to the retailer who is too small to be economically serviced by the wholesalers. The retailer takes his van or car to the cash and carry depot, loads his requirements on a trolley and pays cash to obtain the goods.

As well as saving by eliminating number of deliveries, the cash and carry operator cuts costs of credit and credit control. Usually, he benefits by low occupancy costs from sheer size and by locating away from city areas. By passing on most of these savings, the cash and carry operator can offer his customers very reasonable terms, often selling at low prices and operating on the manufacturer's quantity discount as margin.

Overall, the retail trade in the US has been aided by the introduction of just-in-time (JIT) deliveries and point-of-sale (POS) information technology that has helped to reduce costly inventories. The JIT system integrates wholesaling activities, physical distribution of merchandise and the retail operation to eliminate costly inventory levels and avoid merchandise stock-outs. For example, orders are placed electronically through centralised computer system. The orders are then prepared and sorted automatically by the manufacturers and then transported either direct to the retailer's store or to designated distribution centre. POS data benefits the supply chain by allowing fewer product returns and quicker supply response as well as lowering inventory levels.

And then there are those deliveries covered by the distribution intermediaries. According to one study, there are approximately 300,000 distributors (excluding the retailers) in the US, representing over US$2.5 trillion in annual revenue. Wholesale distribution contributes 16% to the value of the US Gross Domestic Product (GDP). Most distribution channels are still highly fragmented and made up of many privately held companies (Adam J. Fein, 1999).

The primary function of the intermediaries such as the wholesalers is seen as improving the efficiency of the distribution system. Wholesalers are therefore only economically useful if the services and functions they provide are cheaper than the cost of direct distribution. American grocery wholesalers carry a complete line of products for the select group of stores that they supply. Although the American distribution system is multi-levelled, there are generally two types of wholesalers.

The primary wholesaler is the larger of the two and acts as the sales representative of the manufacturing company. The primary wholesaler buys directly from the manufacturer and distributes products to large supermarket chains and major department stores. The secondary wholesaler is a smaller firm that buys and distributes to small retailers a specific line of products carried by the primary wholesaler. These wholesalers usually have small geographical distribution areas and act as a collection agency with the many small "mom and pop" stores that they supply. The two wholesalers work in co-operation as the secondary wholesaler is in a constant state of financial instability, since late payment or non-payment is common among the smaller retailers. The primary wholesaler often extends credit to the financially pressed secondary wholesaler (Nancy M. Childs, 1997).

In January 1994, industry leaders in US concluded an investigation that estimated that as much as US$30 billion could be eliminated from the grocery distribution system through more coordinated retailer-supplier efforts. Much of this US$30 billion was being wasted the report indicated, because of inefficiencies in product assortment, product introductions, promotions and replenishment. Such findings have led to the development of concepts such as the Efficient Consumer Response (ECR), which attempts to eliminate unneeded and redundant costs from the grocery distribution channels (Edward W. Laughlin, Debra J. Perosio and John L. Park, 1998). Initiatives like ECR have become especially important given the increasing consolidation and management sophistication of both manufacturing and distribution companies coupled with the greater demands placed on individual item performance as a result of new product proliferation and increasing customers' demands. This concept will be covered under the chapter on distribution performance enhancing practices.

2.3 Distribution System In Less Developed Countries

As literature on distribution system in the less developed countries is poor, the Malaysian grocery distribution structure is employed to explain the characteristics of the distribution system in such countries.

The Malaysian distribution channel can be described as a complicated network of relationship-based middlemen who interact closely with manufacturers, wholesalers, importers and retailers. The degree of complexity is usually determined by the industry type, the financial linkages among channel members, the size of the retailer and the size & brand recognition of the manufacturer.

Wholesale intermediaries act between manufacturers and retailers by buying and reselling, that is, they provide a channel for exchange. To keep constant supply to the smaller retail establishments who usually order in small quantities on a wide assortment, the need for wholesalers is significant in Malaysia. The rationale is that wholesalers can purchase in large quantities from manufacturers and divide them into smaller quantities that are sold to retailers. Most wholesale merchants perform the physical distribution functions of collecting from manufacturers (locating sources of supply), storing, breaking bulk, assembling and dispersing to retailers or industrial users. Except in the case of very broad-line manufacturers or very large volume retailers or industrial users, economies arise when these wholesalers' functions are performed by separate institutions, because the fixed costs of selling, transportation, storage and handling can be spread over more units. For most manufacturers therefore, there is a presumption in favour of using wholesalers as their distribution channel.

With the existence of chain stores or "multiples" in Malaysia, wholesalers have been losing share of trade in many sectors. The chain stores do their own physical distribution while some manufacturers opt for direct distribution on their own.

While more exact and up-to-date data is not available from the Malaysian Statistics Department, a survey conducted in 1993 revealed that there were a total of 22,940 wholesale establishments in Malaysia. These establishments recorded sales of RM101.7 billion of which, specialised stores dealing in industrial, agricultural & business equipment & materials accounted for the largest share, that is 37.3%, of the total sales value. Specialised stores dealing in household & personal goods; motor trading & motor accessories; and food, drinks & tobacco accounted for 19.0%, 15.3% and 13.8% respectively of the total sales value. Non specialised wholesale stores, however, accounted for the remaining 14.6% of the total sales value of the sector (Survey of Wholesale and Retail Trade and Catering, 1993).

There are generally 3 different levels of wholesalers in the Malaysian grocery business; trading companies, primary wholesalers and secondary wholesalers. Trading companies are large wholesale intermediaries that normally distribute a wide spectrum of products encompassing local and imported grocery items to other wholesalers. The primary wholesaler sometimes purchases only limited brands of merchandise in large quantities and supplies the merchandise to the secondary wholesalers or industrial buyers. At the succeeding stage, the secondary wholesaler consolidates a variety of goods from the primary wholesalers and delivers a wide assortment of goods in small quantities to 'mom and pop' stores. It also maintains large inventories, makes a quick delivery, accepts unsold goods and sends some of its employees to help promote special sales for mom and pop stores.

Through the multi-layered channel, downstream wholesalers can afford to make small deliveries of less than truckload quantities on a frequent basis via vans and scooters. Such delivery service would help the small mom and pop retailers with limited space to replenish their inventories without carrying them. Through quick negotiations and bulk breaking, the wholesalers help move products rapidly from production to retail and consumption.

Besides the wholesalers and distributors, principal appointed agents are also a part of the distribution system. Agents exist to provide a variety of marketing services in particular personal selling fits well into the marketing structure of a wide variety of sizes and types of firms. Agents are useful to firms selling some of their products to markets or outlets other than that of the major line; to firms who are extending coverage to markets too distant or too dispersed for the cost of direct salesman. Agents are also appealing to firms whose seasonal products need year round contact but would not justify year-round salesmen and to firms launching new products, driving for wider distribution or undertaking a promotional burst. Moreover, in some markets changing conditions are giving rise to an increasing use of specialised types of agents. These agents merchandise goods and services on behalf of their principals to the retail trade although they never take title to the goods but instead earn a commission or earn a fee-based income for the services that they provide.

With the proliferation of shopping malls and the rising affluence of the Malaysian consumers, various grocery retail formats were introduced into the Malaysian market, such as major supermarket chains, cash & carry outlets and the hypermarkets.

The supermarkets and cash & carry stores are similar in concept to the ones in the US as described in the foregoing chapter. The hypermarkets are briefly explained as follows.

Hypermarkets

Hypermarkets are giant stores that offer a broader range of goods. Besides food items, these hypermarkets offer general household and departmental goods to mostly the middle and lower income groups. Although they carry a broader range of goods that just supermarket items, the hypermarket operators limit the selection of goods within a category by carrying fewer brands. The hypermarkets may for example, offer only three brands of coffee unlike the supermarkets which carry a full range of coffee. By carrying mostly the leading brands required by the masses and a limited range of secondary brands, the hypermarkets drive up the volume that they buy from manufacturers in return for lower purchase costs. These savings are passed on to their customers in the form of lower retail prices.

The large retailers, mostly foreign-owned, operate their own distribution centres which consolidate deliveries according to store-specific orders. In contrast to the traditional practice of delivering goods to specific outlets, manufacturers, trading companies and wholesalers are now required to deliver to the retailer's centralised warehouse for further consolidation and subsequent delivery to the retail outlets. By operating their own distribution or logistic network, such retailers hope to benefit from cost savings attributable to the removal of the middlemen and through volume purchases. Such retailers with their buying clout are dramatically impacting the traditional supply chain.

The above development is an interesting twist to the findings in the article, "The wheel of retailing in Malaysia" in the late seventies (Sieh, 1979). In this article, Professor Malcolm McNair's "wheel of retailing" was examined in the context of the Malaysian environment.

McNair's hypothesis attempted to explain structural changes exhibited by retail institutions by postulating that new, that is, unconventional retail methods tend to attract customers through a strategy of extreme low price made possible by offering minimal or none of the services that typically accompany traditional retail transactions. Once a foothold is gained, the new retailers tend to abandon their low status, low margin and low price strategy and move around the "wheel" toward services and customer facilities, hence resulting in higher cost and higher price. In so doing, the "wheel' turns to give way to yet newer, lower cost outlets stripped of elaborate services. Again as these retailers eventually develop and embellish themselves with extras, they move around the "wheel" to instigate another turn (Sieh, 1979).

It was concluded in that article that the "wheel" of retailing in Malaysia, was turned by offering more and better customer services and facilities in line with a high-status and high-price strategy, rather than by methods of minimal service cum low price. The trend of continued economic expansion and income growth experienced by the country since independence was offered as a possible and important explanation for the "wheel" to turn in the opposite direction. On the other hand, the low price, minimal service strategy was more important for maintaining established forms of retail outlets instead of for spearheading new methods in the highly competitive retail scene. Retail institutions that were already in existence in the mid-seventies, for example, large retail chains, strived to maintain themselves in a highly competitive situation. It was not surprising to find changes in their marketing strategies especially when the needs for which they originally catered for, are better met by other newer retailers. A variety of low-priced strategy began to emerge, for example, bait pricing, leadership pricing, psychological pricing etc. Other non-price promotional activities such as customers' contest and gift offers, were employed to increase store traffic and off-take from shelves in large scale supermarkets and the many emporium stores (Sieh, 1979).

In the nineties, the "wheel of retail" appears to be turning still towards more services and customer facilities that result in higher costs and higher prices amidst a highly competitive market place. While this is so, retailers appear not to be further turning the wheel to give way to newer, lower cost outlets stripped of elaborate services. But rather, they seek new methods to reduce costs in the highly competitive retail scene such as the removal of the wholesaler and middle layers from the distribution network.

As for the manufacturers who previously relied on wholesalers or distributors to serve all of their retail accounts, they now rationalise their distribution structure to bypass the wholesalers so as to serve the major customer accounts direct through their own distribution set up, while their appointed wholesalers or distributors continue to handle the smaller retail accounts. One factor in this is the manufacturer's ability to promote his products to the smaller retailers via the wholesaler's contract sales forces to push new products and promotions thus reducing the need for a manufacturer permanent sales force calling on the small retailers. Most important, however, is that an examination of the cost-revenue situation will reveal the low efficiency of the direct method of distribution for a multiplicity of small accounts.

To the enterprising manufacturers who are prepared to integrate more closely with his wholesalers or distributors, to rationalise his physical distribution and reconsider his whole distribution strategy afresh would mean a profit opportunity.