16

Distribution decisions

Contents

Learning objectives

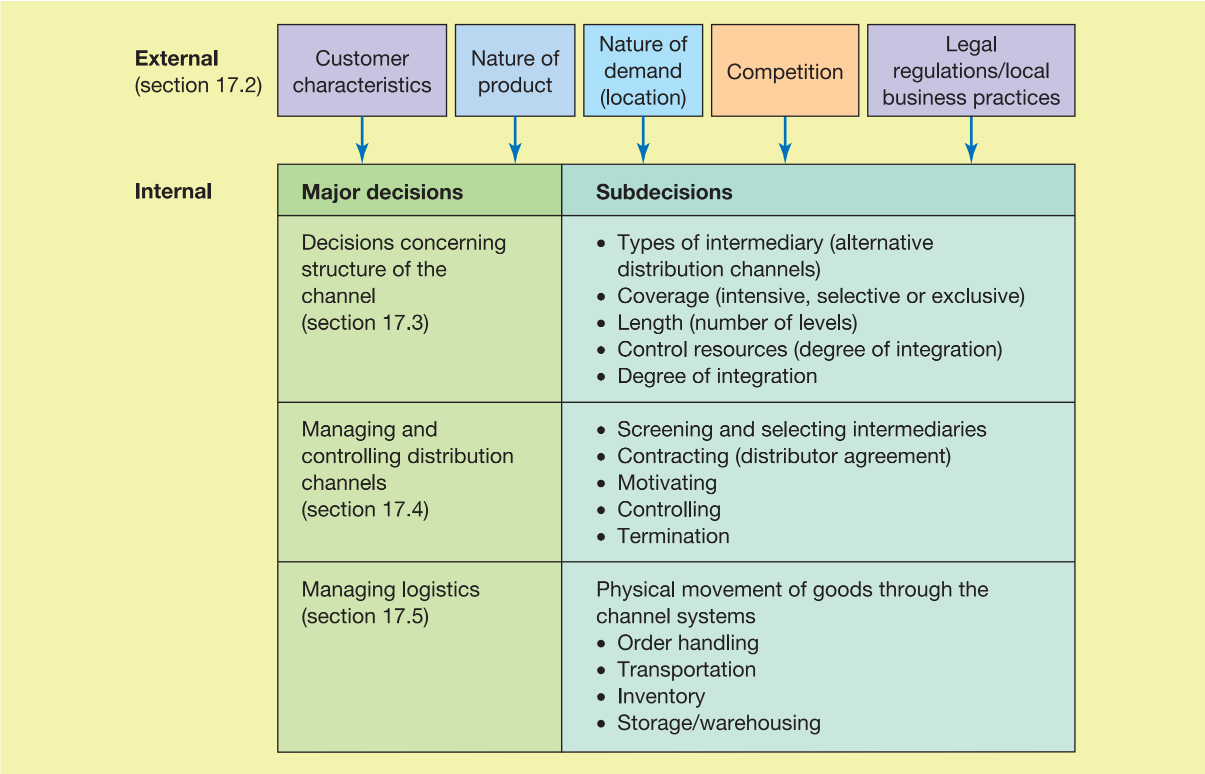
After studying this chapter you should be able to do the following:

- **Explore the determinants of channel decisions.**
- **Discuss the key points in putting together and managing global marketing channels.**
- **Discuss the factors influencing channel width (intensive, selective or exclusive coverage).**
- **Explain what is meant by integration of the marketing channel.**
- **Describe the most common export documents.**
- **Define and explain the main modes of transportation.**
- **Explain how the internationalisation of retailing affects the manufacturer.**
- **Define grey markets and explain how to deal with them.**

16.1 Introduction

Access to international markets is a key decision area facing firms into the 2000s. In Part III we considered the firm's choice of an appropriate market entry mode that could assure the entry of a firm's products and services into a foreign market. After the firm has chosen a strategy to get its products into foreign markets the next challenge (and the topic of this chapter: see Figure 16.1) is the distribution of the products

Figure 16.1 Channel decisions



within those foreign markets. The first part of this chapter concerns the structure and management of foreign distribution. The second part is concerned with the management of international logistics.

According to Table 16.1, distribution channels typically account for 15–40 per cent of the retail price of goods and services in an industry.

Over the next few years the challenges and opportunities for channel management will multiply, as technological developments accelerate channel evolution. Data networks are increasingly enabling end users to bypass traditional channels and deal directly with manufacturers and service providers.

Electronic data interchange is now used for the exchange of orders and invoices between suppliers and their customers. By online monitoring of stocks customers are also able to order directly from suppliers on a just-in-time basis, and thereby to avoid holding stock altogether or to minimize the time it is held.

Table 16.1 Value added in the vertical chain (% of retail price, estimated)

Actor in the vertical chain	Cars	Software	Petrol	Laser printers	Packaged goods
Supplier of raw materials/components	45	10	53	40	26
Manufacturer of finished goods	40	65	19	30	33
Distribution channel	15	25	28	30	41
Total	100	100	100	100	100

Source: Bucklin *et al*., 1996, p. 106. The figures in the table are based on research conducted by, among others, the Economist Intelligence Unity and McKinsey.

At the same time new channels are continuing to emerge in one industry after another, opening up opportunities for companies to cut costs or improve their effectiveness in reaching specific market segments. Catalogue retailing, telephone ordering, cable TV shopping and Internet ordering are all becoming increasingly important to consumer goods manufacturers. Despite the scale and importance of these opportunities, however, few companies manage to take full advantage of them.

The following presents a systematic approach to the major decisions in international distribution. The main channel decisions and their determinants are illustrated in Figure 16.1. Distribution channels are the links between producers and final customers. In general terms, an international marketer distributes either directly or indirectly. As we saw in Chapter 10, direct distribution amounts to dealing with a foreign firm, while the indirect method means dealing with another home country firm that serves as an intermediary. Figure 16.1 shows that the choice of a particular channel link will be strongly influenced by various characteristics of the host markets. We will now consider these in more detail.

16.2 External determinants of channel decisions

Customer characteristics

The customer, or final consumer, is the keystone in any channel design. Thus the size, geographic distribution, shopping habits, outlet preferences and usage patterns of customer groups must be taken into account when making distribution decisions.

Consumer product channels tend to be longer than industrial product channels because the number of customers is greater, the customers are more geographically dispersed, and they buy in smaller quantities. Shopping habits, outlet preferences and usage patterns vary considerably from country to country and are strongly influenced by sociocultural factors.

Nature of product

Product characteristics play a key role in determining distribution strategy. For low-priced, high-turnover convenience products, the requirement is an intensive distribution network. On the other hand it is not necessary or even desirable for a prestigious product to have wide distribution. In this situation a manufacturer can shorten and narrow its distribution channel. Consumers are likely to do some comparison shopping and will actively seek information about all brands under consideration. In such cases limited product exposure is not an impediment to market success.

Transportation and warehousing costs of the product are also critical issues in the distribution and sale of industrial goods such as bulk chemicals, metals and cement. Direct selling, servicing and repair, and spare parts warehousing dominate the distribution of such industrial products as computers, machinery and aircraft. The product's durability, ease of adulteration, amount and type of customer service required, unit costs and special handling requirements (such as cold storage) are also significant factors.

Nature of demand/location

The perceptions that the target customers hold about particular products can force modification of distribution channels. Product perceptions are influenced by the customer's income and product experience, the product's end use, its life cycle position and the country's stage of economic development.

The geography of a country and the development of its transportation infrastructure can also affect the channel decision.

Competition

The channels used by competing products and close substitutes are important because channel arrangements that seek to serve the same market often compete with one another. Consumers generally expect to find particular products in particular outlets (e.g. speciality stores), or they have become accustomed to buying particular products from particular sources. In addition, local and global competitors may have agreements with the major wholesalers in a foreign country that effectively create barriers and exclude the company from key channels.

Sometimes the alternative is to use a distribution approach totally different from that of the competition and hope to develop a competitive advantage.

Legal regulations/local business practices

A country may have specific laws that rule out the use of particular channels or intermediaries. For example, until recently all alcoholic beverages in Sweden and Finland had to be distributed through state-owned outlets. Other countries prohibit the use of door-to-door selling. Channel coverage can also be affected by law. In general, exclusive representation may be viewed as a restraint of trade, especially if the product has a dominant market position. EU antitrust authorities have increased their scrutiny of exclusive sales agreements. The Treaty of Rome prohibits distribution agreements (e.g. grants of exclusivity) that affect trade or restrict competition.

Furthermore, local business practices can interfere with efficiency and productivity and may force a manufacturer to employ a channel of distribution that is longer and wider than desired. Because of Japan's multitiered distribution system, which relies on numerous layers of intermediaries, foreign companies have long considered the complex Japanese distribution system as the most effective non-tariff barrier to the Japanese market.

Exhibit 16.1 shows how the Japanese distribution system differs from its counterparts in the United States and Europe.

Exhibit 16.1 The distribution system in Japan

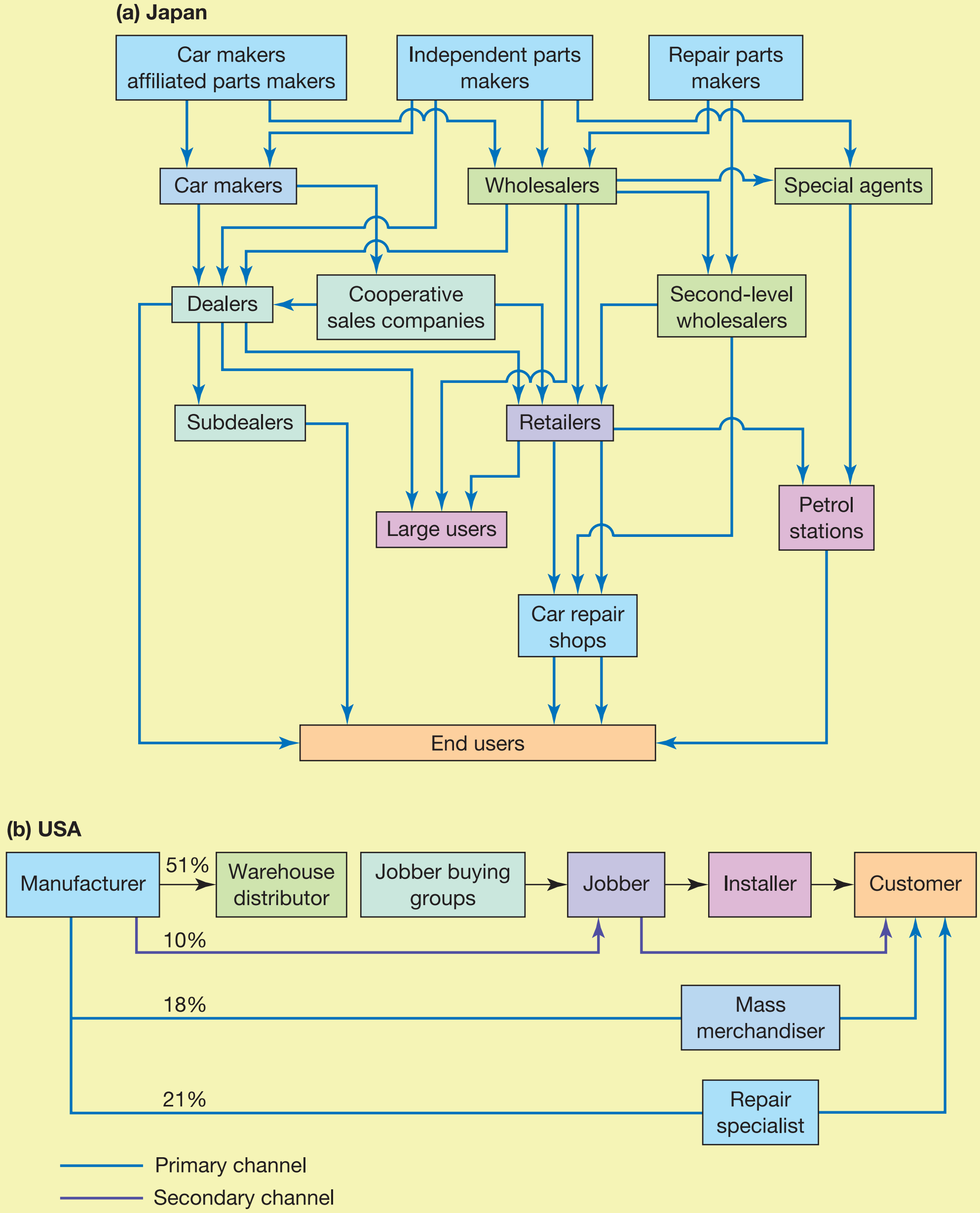
The distribution network in Japan has more wholesalers and retailers per capita than any other industrial nation (Onkvisit and Shaw, 1993, p. 598). Figure 16.2 illustrates the difference between shorter US channels and the long and complex Japanese channels.

A consequence of the more complex Japanese distribution system is the considerable price escalation from producer to consumer, as shown in Figure 16.3. (The principle behind price escalation is shown in Table 15.1.)

The first transaction in Figure 16.3, from producer to wholesaler, is a *vertical* exchange, whereas the next transaction (from one wholesaler to another) is a *horizontal* exchange. Small Japanese distributors often lack adequate inventory to serve another distributor at the same vertical level (i.e. horizontal exchange). According to economic criteria, the Japanese distribution system would seem to be inefficient, resulting in higher consumer prices.

Exhibit 16.1 continued

Figure 16.2 Comparison of distribution channels in car parts between Japan and the USA

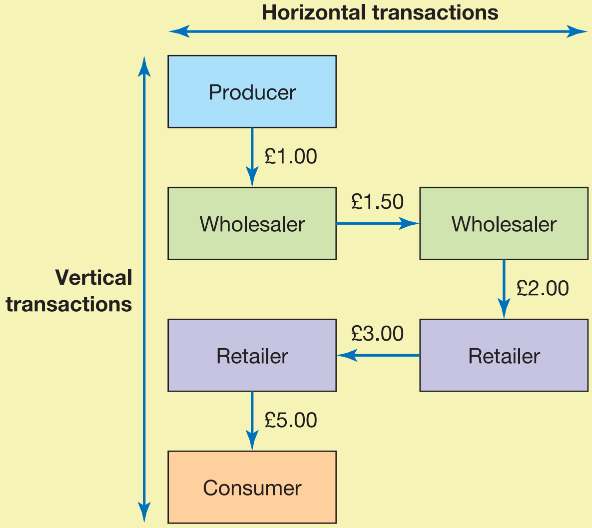


Source: Cateora, 1993, *International Marketing*, 8th Edition, p. 432. Reproduced with kind permission of the McGraw-Hill Companies.

However, the complex Japanese distribution system exists to serve social as well as economic purposes. Channel members are like family members and their relationships to each other are tightly interlocked by tradition and emotion. Because of these social considerations inefficient channel members are sometimes retained and tolerated in order to maintain employment and income flows. For example, one of the primary concerns of Japanese channel managers is to help other channel members preserve their dignity. Going out of business is viewed as disgraceful, so stronger channel members (typically producers) must often support weak distributors. The Japanese system is often seen as a trade barrier by western firms, but it is likely that these foreign firms have merely failed to understand the system.

Sources: Cateora (1993); Onkvisit and Shaw (1993); Pirog and Lancioni (1997).

Figure 16.3 A hypothetical channel sequence in the Japanese consumer market



Source: Pirog and Lancioni, 1997, p. 57. Adapted with kind permission from *International Journal of Physical Distribution and Logistics Management*, Emerald Group Publishing Ltd.

Let us now return to the major decisions concerning the structure of the distribution channel (Figure 16.1).

16.3 The structure of the channel

Market coverage

Market coverage
Coverage can relate to geographical areas or number of retail outlets. Three approaches are available: intensive, selective or exclusive coverage.

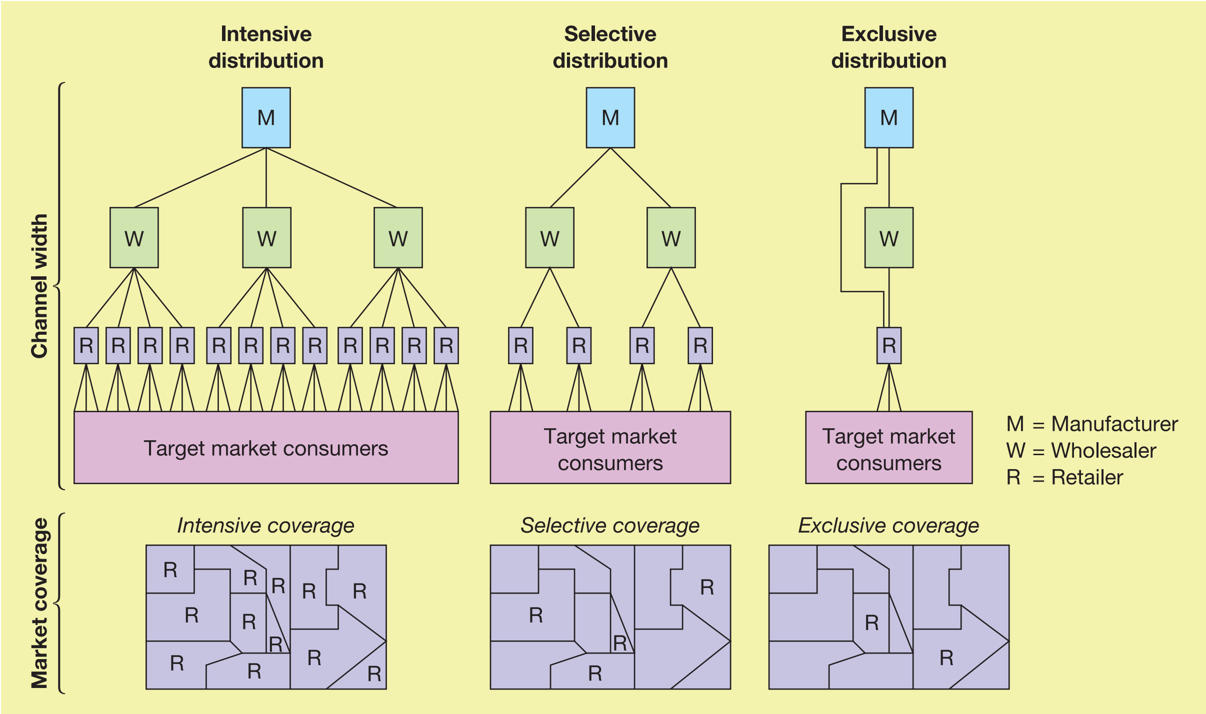
The amount of **market coverage** that a channel member provides is important. Coverage is a flexible term. It can refer to geographical areas of a country (such as cities and major towns) or the number of retail outlets (as a percentage of all retail outlets). Regardless of the market coverage measure(s) used the company has to create a distribution network (dealers, distributors and retailers) to meet its coverage goals.

As shown in Figure 16.4, three different approaches are available:

1 *Intensive coverage*. This calls for distributing the product through the largest number of different types of intermediary and the largest number of individual intermediaries of each type.
2 *Selective coverage*. This entails choosing a number of intermediaries for each area to be penetrated.
3 *Exclusive coverage*. This involves choosing only one intermediary in a market.

Channel coverage (width) can be identified along a continuum ranging from wide channels (intensive distribution) to narrow channels (exclusive distribution). Figure 16.5 illustrates some factors favouring intensive, selective and exclusive distribution.

Figure 16.4 Three strategies for market coverage



Source: Lewison, 1996, p. 271.

Figure 16.5 Factors influencing channel width

		Channel width		
		Intensive distribution	↔ *Selective distribution* ↔	*Exclusive distribution*
Factor	*Product type*	Convenience products	↔	Speciality products
	Product life cycle stage	Mature products	↔	New products
	Product price	Low-price products	↔	High-price products
	Brand loyalty	Brand-preferred products	↔	Brand-insisted products
	Purchase frequency	Frequently purchased products	↔	Infrequently purchased products
	Product uniqueness	Common products	↔	Distinctive products
	Selling requirement	Self-service products	↔	Personal-selling products
	Technical complexity	Non-technical products	↔	Technical products
	Service requirements	Limited-service products	↔	Extensive-service products

Source: adapted from Lewison, 1996, p. 279.

Channel length
Number of levels (middlemen) in the distribution channel.

Channel length

This is determined by the number of levels or different types of intermediaries. Longer channels, those with several intermediaries, tend to be associated with convenience goods and mass distribution. As seen in Exhibit 16.1, Japan has longer channels for convenience goods because of the historical development of its system. One implication is that prices increase considerably for the final consumer (price escalation: see section 15.3).

Control/cost

The 'control' of one member in the vertical distribution channel means its ability to influence the decisions and actions of other channel members. Channel control is of critical concern to international marketers wanting to establish international brands and a consistent image of quality and service worldwide.

The company must decide how much control it wants to have over how each of its products is marketed. The answer is partly determined by the strategic role assigned to each market. It is also a function of the types of channel member available, the regulations and rules governing distribution activity in each foreign market, and to some extent the roles traditionally assigned to channel members.

Normally a high degree of control is provided by the use of the firm's own sales force in international markets. The use of intermediaries will automatically lead to loss of some control over the marketing of the firm's products.

An intermediary typically performs certain functions:

- carrying of inventory;
- demand generation, or selling;
- physical distribution;
- after-sales service;
- extending credit to customers.

In getting its products to end-user markets a manufacturer must either assume all of these functions or shift some or all of them to intermediaries. As the old saying goes, 'You can eliminate the intermediary, but not the functions of the intermediary.'

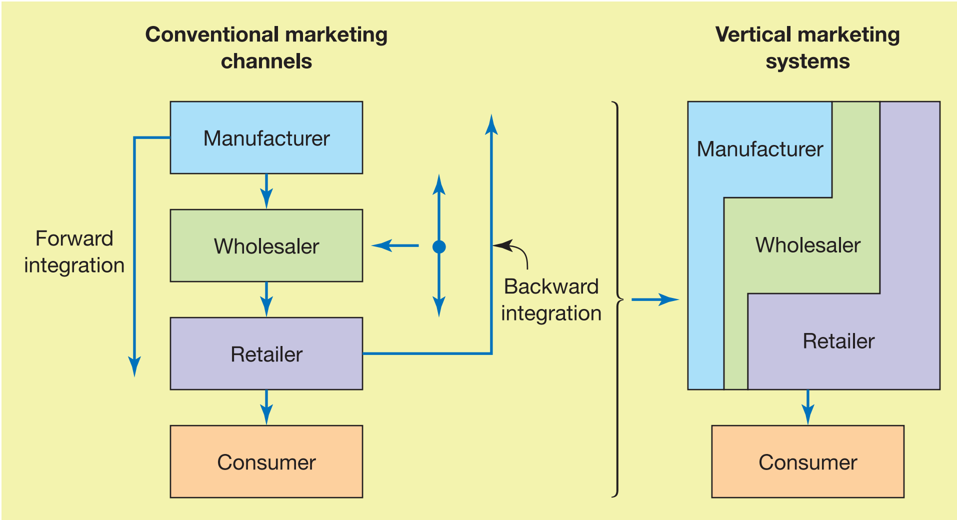
In most marketing situations there is a trade-off between a producer's ability to control important channel functions and the financial resources required to exercise that control. The more intermediaries involved in getting a supplier's product to user customers, the less control the supplier can generally exercise over the flow of its product through the channel and the way it is presented to customers. On the other hand, reducing the length and breadth of the distribution channel usually requires that the supplier perform more functions itself. In turn this requires the supplier to allocate more financial resources to activities such as warehousing, shipping, credit, field selling or field service.

In summary, the decision to use an intermediary or to distribute via a company-owned sales force requires a major trade-off between the desire to control global marketing efforts and the desire to minimise resource commitment costs.

Degree of integration

Control can also be exercised through integration. Channel integration is the process of incorporating all channel members into one channel system and uniting them under one leadership and one set of goals. There are two different types of integration:

Figure 16.6 Vertical integration



Vertical integration Seeking control of channel members at different levels of the channel, e.g. the manufacturer's acquisition of the distributor.

Horizontal integration Seeking control of channel members at the same level of the channel, e.g. the manufacturer's acquisition of the competitor.

1 **vertical integration**: seeking control of channel members at different levels of the channel;
2 **horizontal integration**: seeking control of channel members at the same level of the channel (i.e. competitors).

Integration is achieved either through acquisitions (ownership) or through tight cooperative relationships. Getting channel members to work together for their own mutual benefit can be a difficult task. However, today cooperative relationships are essential for efficient and effective channel operation.

Figure 16.6 shows an example of vertical integration.

The starting point in Figure 16.6 is the conventional marketing channels, where the channel composition consists of isolated and autonomous participating channel members. Channel coordination is here achieved through arm's-length bargaining. At this point, the vertical integration can take two forms – forward and backward.

- The manufacturer can make forward integration when it seeks control of businesses of the wholesale and retail levels of the channel.
- The retailer can make backward integration, seeking control of businesses at wholesale and manufacturer levels of the channel.
- The wholesaler has two possibilities: both forward and backward integration.

The result of these manoeuvres is the vertical marketing system (Figure 16.6). Here the channel composition consists of integrated participating members, where channel stability is high due to assured member loyalty and long-term commitments.

16.4 Managing and controlling distribution channels

In the beginning of a market entry, partnerships with local distributors make good sense: Distributors know the distinctive characteristics of their market, and most customers prefer to do business with local partners. Arnold (2000) propose the following guidelines to the international marketer (manufacturer) in order to anticipate and correct potential problems with international distributors:

- *Select distributors – do not let them select you:* Typically, manufacturers are approached by potential distributors at international fairs and exhibitions, but the most eager potential distributors are often the wrong people to partner with.
- *Look for distributors capable of developing markets, rather than those with a few obvious contacts:* This means sometimes bypassing the most obvious choice – the distributor who has the right customers and can generate quick sales – in favour of a partner with a greater willingness to make long-term investments and an acceptance of an open relationship.
- *Treat the local distributors as long-term partners, not temporary market-entry vehicles:* Many companies actively signal to distributors that their intentions are only for the short term, drawing up contracts that allow them to buy back distribution rights after a few years. Under such a short-term agreement the problem is that the local distributor does not have much incentive to invest in the necessary long-term marketing development.
- *Support market entry by committing money, managers, and proven marketing ideas:* Many manufacturers are reluctant to commit resources at the early stages of a market entry. However, to retain strategic control, the international marketer must commit adequate corporate resources. This is especially true during market entry, when companies are least certain about their prospect in new countries.
- *From the start, maintain control over marketing strategy:* An independent distributor should be allowed to adapt the manufacturer's strategy to local conditions. However, only companies providing solid leadership for marketing will be in a position to exploit the full potential of a global marketing network.
- *Make sure distributors provide you with detailed market and financial performance data:* Most distributors regard data like customer identification and local price levels as key sources of power in the relationship with the manufacturer. But the manufacturer's ability to exploit its competitive advantages in the international market depends heavily on the quality of information it obtains from the market. Therefore a contract with the distributor must include the exchange of such information, like detailed market and financial performance data.
- *Build links among national distributors at the earliest opportunity:* The links may take form of creating an independent national distributor council or a regional corporate office. The transfer of ideas within local markets can improve performance and result in greater consistency in the execution of international marketing strategies because links to other national distributor networks could be established. This could lead to a cross-national transfer of efficient marketing tools.

Once the basic design of the channel has been determined the international marketer must begin to fill it with the best available candidates, and must secure their cooperation.

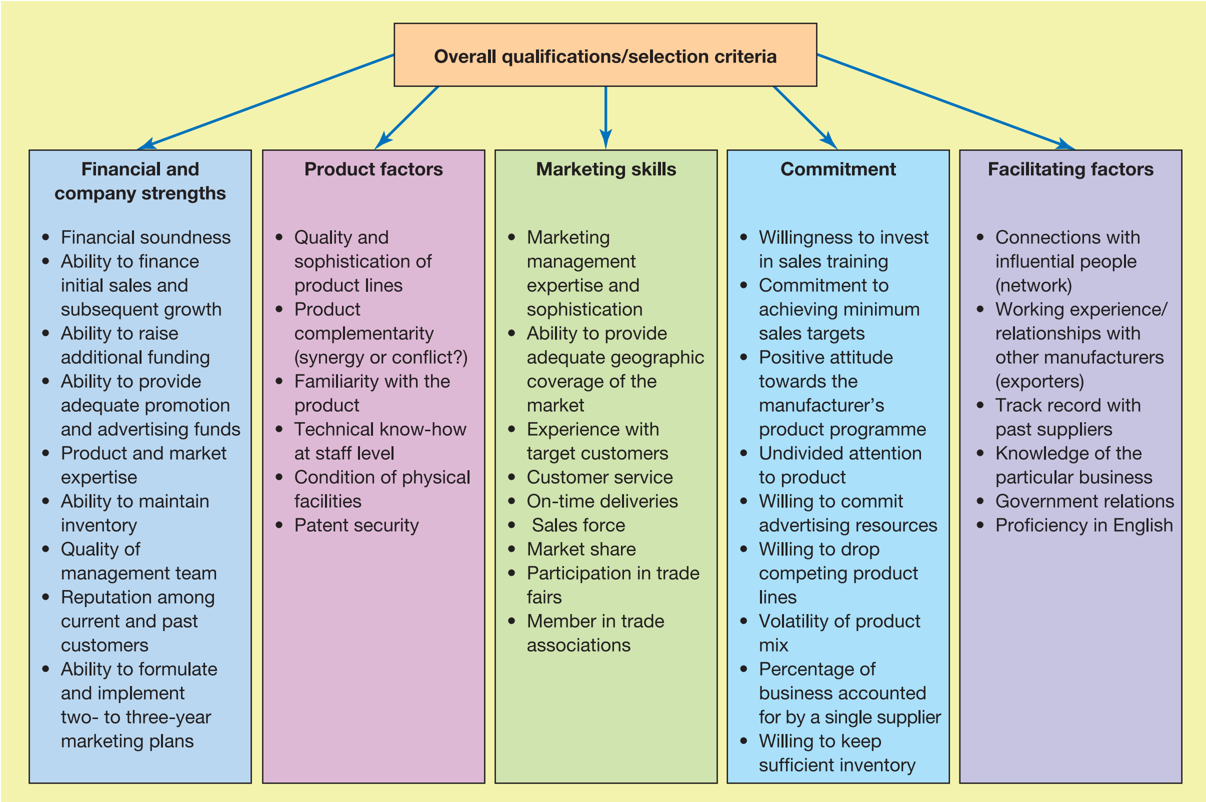
Screening and selecting intermediaries

Figure 16.7 shows the most important criteria (qualifications) for selecting foreign distributors, grouped in five categories.

After listing all important criteria (like in Table 16.1), some of these must then be chosen for a more specific evaluation, where the potential candidates are compared and contrasted against determining criteria.

The example in Table 16.2 uses the first two criteria in each of Table 16.1's five categories for screening potential channel members, in total ten criteria. The specific criteria to be used depend on the nature of a firm's business and its distribution objectives in given markets. The list of criteria should correspond closely to the

Figure 16.7 Criteria for evaluating foreign distributors



Source: Adapted from Cavusgil *et al*. (1995).

marketer's own determinants of success – all the things that are important to beating the competition.

The hypothetical manufacturer (a consumer packaged goods company) used in Table 16.2 considered the distributor's marketing management expertise and financial soundness to be of greatest importance. These indicators will show whether the distributor is making money and is able to perform some of the necessary marketing functions such as extension of credit to customers and risk absorption. Financial reports are not always complete or reliable, or may lend themselves to differences of interpretation, pointing to the need for a third-party opinion. In order to make the weighting and grading in Table 16.2, the manufacturer must have had some personal interviews with the management of each potential distributor. In the example of Table 16.2, *Distributor 1 would be selected by the manufacturer*.

Alternatively, an industrial goods company may consider the distributor's product compatibility, technical know-how and technical facilities, and service support, of high importance, and the distributor's infrastructure, client performance and attitude towards its products of low importance. Quite often global marketers find that the most desirable distributors in a given market are already handling competitive products and are therefore unavailable.

A high-tech consumer goods company, on the other hand, may favour financial soundness, marketing management expertise, reputation, technical know-how, technical facilities, service support and government relations. In some countries religious or ethnic differences might make an agent suitable for one part of the market coverage but unsuitable for another. This can result in more channel members being required in order to give adequate market coverage.

Table 16.2 An example of distributor evaluation by the use of selection criteria from Figure 16.7

Criteria (no ranking implied)	Weight	Distributor 1 Rating	Distributor 1 Score	Distributor 2 Rating	Distributor 2 Score	Distributor 3 Rating	Distributor 3 Score
Financial and Company strengths:							
Financial soundness	4	5	20	4	16	3	12
Ability to finance initial sales and subsequent growth	3	4	12	4	12	3	9
Product factors:							
Quality and sophistication of product lines	3	5	15	4	12	3	9
Product complementarity (synergy or conflict?)	3	3	9	4	12	2	6
Marketing skills:							
Marketing management expertise and sophistication	5	4	20	3	15	2	10
Ability to provide adequate geographic coverage of the market	4	5	20	4	16	3	12
Commitment:							
Willingness to invest in sales training	4	3	12	3	12	3	12
Commitment to achieving minimum sales targets	3	4	12	3	9	3	9
Facilitating Factors:							
Connections with influential people (network)	3	5	15	4	12	4	12
Working experience / relationships with other manufacturers (exporters)	2	4	8	3	6	3	6
Score			**143**		**122**		**94**

Scales:

Rating	*Weighting*
5 Outstanding	5 Critical success factor
4 Above average	4 Prerequisite success factor
3 Average	3 Important success factor
2 Below average	2 Of some importance
1 Unsatisfactory	1 Standard

Contracting (distributor agreements)

When the international marketer has found a suitable intermediary a foreign sales agreement is drawn up. Before final contractual arrangements are made it is wise to make personal visits to the prospective channel member. The agreement itself can be relatively simple but, given the numerous differences in the market environments, certain elements are essential. These are listed in Figure 16.8.

The long-term commitments involved in distribution channels can become particularly difficult if the contract between the company and the channel member is not carefully drafted. It is normal to prescribe a time limit and a minimum sales level to be achieved, in addition to the particular responsibilities of each party. If this is not

Figure16.8 Items to include in an agreement with a foreign intermediary (distributor)

- Names and addresses of both parties.
- Date when the agreement goes into effect.
- Duration of the agreement.
- Provisions for extending or terminating the agreement.
- Description of sales territory.
- Establishment of discount and/or commission schedules and determination of when and how paid.
- Provisions for revising the commission or discount schedules.
- Establishment of a policy governing resale prices.
- Maintenance of appropriate service facilities.
- Restrictions to prohibit the manufacture and sale of similar and competitive products.
- Designation of responsibility for patent and trade mark negotiations and/or pricing.
- The assignability or non-assignability of the agreement and any limiting factors.
- Designation of the country and state (if applicable) of contract jurisdiction in the case of dispute.

Source: From *International Marketing Management 5th Edition* by Jain. 1996. Reprinted with permission of South-Western, a division of Thomson Learning: www.thomsonrights.com. Fax 800 730-2215.

carried out satisfactorily the company may be stuck with a weak performer that either cannot be removed or is very costly to buy out from the contract.

Contract duration is important, especially when an agreement is signed with a new distributor. In general, distribution agreements should be for a specified, relatively short period (one or two years). The initial contract with a new distributor should stipulate a trial period of either three or six months, possibly with minimum purchase requirements. Duration is also dependent on the local laws and their stipulations on distributor agreements.

Geographic boundaries for the distributor should be determined with care, especially by smaller firms. Future expansion of the product market might be complicated if a distributor claims rights to certain territories. The marketer should retain the right to distribute products independently, reserving the right to certain customers.

The *payment section* of the contract should stipulate the methods of payment as well as how the distributor or agent is to draw compensation. Distributors derive compensation from various discounts, such as the functional discount, whereas agents earn a specific commission percentage of net sales (typically 10–20 per cent). Given the volatility of currency markets the agreement should also state the currency to be used.

Product and conditions of sale need to be agreed on. The products or product lines included should be stipulated, as well as the functions and responsibilities of the intermediary in terms of carrying the goods in inventory, providing service in conjunction with them, and promoting them. Conditions of sale determine which party is to be responsible for some of the expenses (e.g. marketing expenses) involved, which will in turn have an effect on the price to the distributor. These conditions include credit and shipment terms.

Means of communication between the parties must be stipulated in the agreement if a marketer–distributor relationship is to succeed. The marketer should have access to all information concerning the marketing of its products in the distributor's territory, including past records, present situation assessments and marketing research.

Motivating

Geographic and cultural distance make the process of motivating channel members difficult. Motivating is also difficult because intermediaries are not owned by the company. Since intermediaries are independent firms they will seek to achieve their own objectives, which will not always match the objective of the manufacturer. The international marketer may offer both monetary and psychological rewards. Intermediaries will be strongly influenced by the earnings potential of the product. If the trade margin is poor and sales are difficult to achieve intermediaries will lose interest in the product. They will concentrate upon products with a more rewarding response to selling efforts, since they make their sales and profits from their own assortment of products and services from different companies.

It is important to keep in regular contact with agents and distributors. A consistent flow of all relevant types of communication will stimulate interest and sales performance. The international marketer may place one person in charge of distributor-related communications and put into effect an exchange of personnel so that both organizations gain further insight into the workings of the other.

Controlling

Control problems are reduced substantially if intermediaries are selected carefully. However, control should be sought through the common development of written performance objectives. These performance objectives might include some of the following: sales turnover per year, market share growth rate, introduction of new products, price charged and marketing communications support. Control should be exercised through periodic personal meetings.

Evaluation of performance has to be done against the changing environment. In some situations economic recession or fierce competition activity prevents the possibility of objectives being met. However, if poor performance is established, the contract between the company and the channel member will have to be reconsidered and perhaps terminated.

Termination

Typical reasons for the termination of a channel relationship are as follows:

- The international marketer has established a sales subsidiary in the country.
- The international marketer is unsatisfied with the performance of the intermediary.

Open communication is always needed to make the transition smooth. For example, the intermediary can be compensated for investments made, and major customers can be visited jointly to assure them that service will be uninterrupted.

Termination conditions are among the most important considerations in the distribution agreement. The causes of termination vary and the penalties for the international marketer may be substantial. It is especially important to find out what local laws say about termination and to check what type of experience other firms have had in the particular country.

In some countries terminating an ineffective intermediary can be time consuming and expensive. In the European Union one year's average commissions are typical for termination without justification. A notice of termination has to be given three to six months in advance. If the cause for termination is the manufacturer's establishment of a local sales subsidiary, then the international marketer may consider engaging good employees from the intermediary as, for example, managers in the new sales subsidiary. This can prevent a loss of product know-how that has been created at the intermediary's firm. The international marketer could also consider an acquisition of this firm if the intermediary is willing to sell.

16.5 Managing logistics

Logistics
A term used to describe the movement of goods and services between suppliers and end users.

Logistics is used as a term to describe the movement of goods and services between supplier(s) and end users.

Two major phases in the movement of materials are of logistical importance. The first phase is *materials management*, or the timely movement of raw materials, parts and supplies into and through the firm. The second phase is *physical distribution*, or the movement of the firm's finished product to its customers. The basic goal of logistics management is the effective coordination of both phases and their various components to result in maximum cost effectiveness while maintaining service goals and requirements.

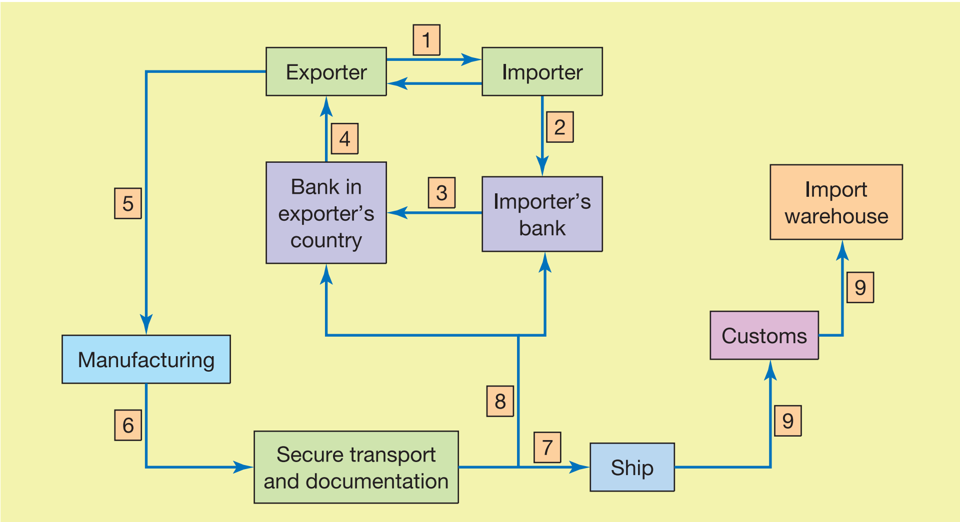
The primary area of concern in this section is the second phase: that is, order handling, transportation, inventory and storage/warehousing.

Order handling

The general procedure for order handling, shipment and payment is shown in Figure 16.9:

1 The sale:
Importer makes enquiry of potential supplier.
Exporter sends catalogues and price list.
Importer requests pro-forma invoice (price quote).
Exporter sends pro-forma invoice.
Importer sends purchase order.
Exporter receives purchase order.
2 Importer arranges financing through its bank (issuing bank).
3 Importer's bank sends letter of credit (most frequently used form of payment) to exporters bank (advising bank).
4 Exporter's bank notifies exporter that letter of credit is received.

Figure 16.9 The export procedure



Source: Albaum *et al*., 1994, p. 419.

5 Exporter produces or acquires goods.
6 Exporter arranges transportation and documentation (obtained by exporter or through freight forwarding company).
Space reserved on ship or aircraft.
Documents acquired or produced, as required:
(a) exporter's licence;
(b) shipper's export declaration;
(c) commercial invoice;
(d) bills of lading;
(e) marine insurance certificate;
(f) consular invoice;
(g) certificate of origin;
(h) inspection certificates;
(i) dock receipts.
7 Exporter ships goods to importer.
8 Exporter presents documents to one of the banks for payment.
9 Importer has goods cleared through customs and delivered to its warehouse.

Source: Albaum *et al*., 1994, p. 419.

Most common export documents

This section is drawn from Albaum *et al*. (1994), p. 440.

Transportation documents

- *Bill of lading*. This is a receipt for the cargo and a contract for transportation between a shipper and a transport carrier. It may also be used as an instrument of ownership.
- *Dock receipt*. This is the document acknowledging receipt of the cargo by an ocean carrier.
- *Insurance certificate*. This is evidence that insurance is provided to cover loss or damage to the cargo while in transit.

Banking documents

- *Letter of credit*. This is a financial document issued by a bank at the request of the importer, guaranteeing payment to the exporter if certain terms and conditions surrounding a transaction are met.

Commercial documents

- *Commercial invoice*. This is a bill for the products from the exporter to the buyer.

Government documents

- *Export declaration*. This includes complete information about the shipment.
- *Consular invoice*. This is a document signed by a consul of the importing country that is used to control and identify goods shipped there.
- *Certificate of origin*. This is a document certifying the origin of products being exported, so that the buying country knows in which country the products were produced.

The enquiry or order for products and/or services may be unsolicited or the result of a firm's efforts (the manufacturer or the agent). When the actual order is received the international marketer will normally send a confirmation of receipt, followed by a commitment to fulfil the order if all of the terms and payment arrangements are acceptable for the international marketer.

A pro-forma invoice may be prepared by the exporter to indicate the terms that have been agreed upon (or are proposed). The pro-forma invoice normally shows the type and amount of merchandise, unit costs and extensions, expected weights and measures, and often other terms (including payment terms). If accepted by the prospective buyer it may serve as a contract.

Order cycles are shortened by rapid processing of orders, and the role of communications technology (such as electronic data interchange) is critical in reducing the time factor. Few countries have efficient and reliable communication systems; however, possessing an efficient international order-processing system would give a firm a competitive advantage.

Transportation

This deals primarily with the mode of transport, which usually constitutes 10–15 per cent of the retail costs of imported goods. There are four main modes of transport: road, water, air and rail.

Road

Roads are very efficient for short hauls of high-value goods, being very flexible in route and time. Goods can be delivered direct to customers' premises. However, restrictions at border controls can be time consuming, and long distances and the need for sea crossings reduce the attractiveness of freight transport by road. In some parts of the world, particularly in LDCs, road surfaces are poor.

Water

Water transportation is a key mode for international freight movements because it provides a very low-cost way to transport bulky products such as coal and oil. However, water transport is slow and is subject to difficulties caused by the weather – for example, some ports are iced over for part of the winter. Water transport usually needs to be combined with other modes of transport to achieve door-to-door delivery.

Increasingly nations have begun to recognize the importance of appropriate port structures and are developing such facilities in spite of the heavy investment necessary. If such investments are accompanied by concurrent changes in the overall infrastructure transportation efficiency should, in the long run, more than recoup the original investment.

Air

Air freight is available to and from most countries. There has been a tremendous growth in international air freight over recent decades. Air freight is considerably more expensive per tonne/kilometre than the other modes of transport. It accounts for less than 1 per cent of the total volume of international transport, but represents more than 20 per cent of the value shipped by industrialized countries (Sletmo and Picard, 1984). High-value items are more likely to be shipped by air, particularly if they have a high weight-to-volume ratio.

Rail

Rail services provide a very good method of transporting bulky goods over long distances. The increasing use of containers provides a flexible means to use rail and road modes, with minimal load transfer times and costs. High-speed trains are also emerging in Europe and the United States as attractive alternatives. For example, in Europe trains travelling at 190 miles per hour have cut the travel time between major European cities.

The decision about which transportation mode to use is affected by a number of factors, including the following:

- cost of different transport alternatives;
- distance to the location;
- nature of the product;
- frequency of the shipment;
- value of the shipment;
- availability of transport.

The level of economic development is a major determinant of the availability of transportation – in some markets air freight is highly developed compared to rail transportation.

Freight forwarders

Freight forwarders provide an important service to exporters. The full-service foreign freight forwarder can relieve the producer of most of the burdens of distribution across national borders. This is particularly so for small and medium-sized companies and those that are inexperienced in exporting. Freight forwarders provide a wide range of services, but the general activities and services are as follows:

- coordination of transport services;
- preparation and processing of international transport documents;
- provision of warehousing;
- expert advice.

The traditional view of the freight forwarder is that of a provider of services, a company that does not own transport facilities but which buys from the most appropriate transport provider, and a company that acts as the agent of the exporter. Various changes have taken place that have impacted upon freight forwarders. There has been a tendency for transport companies to extend their activities to include an in-house forwarding function. In addition, larger and more experienced exporters have developed their own in-house transport and documentation expertise. Both these trends have threatened the freight forwarder.

Inventory (at the factory base)

The purpose of establishing inventory – to maintain product movement in the delivery pipeline, in order to satisfy demand – is the same for domestic and international inventory systems.

There are many different cost elements involved in managing an inventory: storage, interest on capital tied up, taxes, lost sales, etc. Since these costs may sometimes be sizeable management must be concerned about inventory control. This involves determining the proper level of inventory to hold so that a balance is maintained between customer service and inventory cost.

In deciding the level of inventory to be maintained the international marketer must consider two factors:

1. *Order cycle time*: the total time that passes between the placement of an order by a customer and the receipt of the goods. Depending on the choice of transportation mode, delivery times may vary considerably. As a result the marketer has to keep larger safety stock in order to be able to satisfy demand in any circumstance. However, the marketer could attempt to reduce order cycle time, thereby reducing

costs, by altering transportation method, changing inventory locations or shifting order placement to direct computer-order entry (EDI).

2 *Customer service levels*: the ability to fulfil customer orders within a certain time. For example, if within three days 80 per cent of the orders can be fulfilled, the customer service level is 80 per cent. The choice of customer service level for the firm has a major impact on the inventories needed. Because high customer service levels are costly (inventory constitutes tied-up capital) the goal should not be the highest level possible but rather an acceptable level, based on customer expectations. For some products customers may not demand or expect quick delivery. In addition, if higher customer service levels result in higher prices, this may reduce the competitiveness of a firm's product.

Besides these two factors, international inventories can also be used as a strategic tool in dealing with currency valuation changes or hedging against inflation.

Storage/warehousing (in foreign markets)

Sometimes goods and materials need to be stored in the export markets. However, this activity involves more than just storage. In addition to storing products in anticipation of consumer demand warehousing encompasses a broad range of other activities, such as assembling, breaking bulk shipments into smaller sizes to meet customer needs, and preparing products for reshipment.

Warehousing decisions focus on three main issues:

1 where the firm's customers are geographically located;
2 the pattern of existing and future demands;
3 the customer service level required (i.e. how quickly a customer's order should be fulfilled).

The following general observations can be made about warehousing facilities:

- If products need to be delivered quickly storage facilities will be required near the customer.
- For high-value products (e.g. computer software) the location of the warehouse will be of minimal importance as these lightweight products can be air freighted.

Exhibit 16.2 How Bosch-Siemens improved customer service and reduced costs by closing warehouses

Bosch-Siemens (BS) is a leading European manufacturer of consumer white goods, with handsome market shares in Germany, Scandinavia, Spain and Greece. Recently the company decided to reduce the number of its European warehouses from 36 to 10. BS aimed to cut costs and reduce the amount of stock it held. The company also wanted to improve its distribution, enhance customer service and reform its logistics structure to boost its share in other markets, particularly the United Kingdom and France.

The process of continent-wide rationalization took three years to plan. BS fixed on ten sites as its current optimum, based on effective delivery criteria. It wanted to be able to reach customers within 24–48 hours. On the other hand, the optimum size of a warehouse in terms of cost is 20,000–30,000 m^2 Hence BS arrived at ten as its optimum number of warehouses in Europe. These are shown in Figure 16.10.

BS seeks to serve several territories from each warehouse. Thus, for example, it has a warehouse in Sweden that also covers Norway and Finland; and its south German warehouse supplies Luxembourg, Austria and parts of France.

Figure 16.10 **Bosch-Siemens' European distribution centres**

Source: Albaum *et al*., 1994, p. 419.

By cutting warehouses it has reduced total distribution and warehousing costs, brought down staff numbers, holds fewer items of stock, provides greater access to regional markets, makes better use of transport networks and has improved service to customers.

The financial benefit is a saving of DM30 million a year, or a reduction of 21 per cent in total logistics costs. BS has also achieved greater flexibility in the use of transport systems such as rail and waterways. It has brought stock numbers down from 1 million items to 700,000.

Source: EIU (1995).

Packaging

A good balance needs to be achieved between the high costs of the substantial export packing required to eliminate all damage and the price and profit implications that this has for the customer and the exporter.

Export packing has been modified over the years from wooden crates. Different countries have different regulations about what materials are acceptable. One example of this is the recycling of containers for reuse, which requires a system for deposits and returns into the distribution channels. In addition, export packing influences customer satisfaction through its appearance and its appropriateness to minimise handling costs for the customer.

During recent years packaging has been simplified by palletization. Computer software is now available from packaging suppliers that can design individual product packaging to maximize the number of units per pallet, and thus per container load. Palletization with shrink-wrap protection, together with containerization, has served both to protect goods against damage and to diminish losses through theft.

Third-party logistics (contract logistics)

A growing preference among international firms is to employ outside logistical expertise. The main thrust behind the idea is that individual firms are experts in their industry and should therefore concentrate only on their operations. Third-party logistics providers, on the other hand, are experts solely at logistics, with the knowledge and means to perform efficient and innovative services for those companies in need. The goal is improved service at equal or lower cost.

One of the greatest benefits of contracting out the logistics function in a foreign market is the ability to take advantage of an in-place network complete with resources and experience. The local expertise and image are crucial when a business is just starting up.

One of the main arguments levelled against contract logistics is the loss of the firm's control in the supply chain. Yet contract logistics does not and should not require the handing over of control. Rather, it offers concentration on one's core competence, a division of labour. The control and responsibility towards the customer remain with the firm, even though operations may move to a highly trained outside organization.

16.6 Implications of the Internet for distribution decisions

The Internet has the power to change drastically the balance of power among consumers, retailers, distributors, manufacturers and service providers. Some participants in the distribution chain may experience an increase in their power and profitability. Others will experience the reverse; some may even find that they have been bypassed and have lost their market share.

Physical distributors and dealers of goods and services that are more conveniently ordered and/or delivered online are indeed subject to increasing pressure from e-commerce. This *disintermediation* process, with increasing direct sales through the Internet, leads manufacturers to compete with their resellers, which results in *channel conflict*. The extent to which these effects are salient depends upon which of the following *four Internet distribution strategies* are adopted by the manufacturer.

1 Present only product information on the Internet

As less than 10 per cent of retail sales (in both Europe and the United States) presently occur over the Internet, only a few manufacturers would be willing to endanger their relationships with their distributors for that volume. The risk of conflicts with the existing distributors would be too great. So manufacturers may decide not to sell their products through the Internet and also prohibit their resellers from using the Internet for sales. Only product information is provided on the Internet, with any customer queries being passed on to the appropriate channel member. In industries such as aircraft manufacturing, where sales are large, complex and customised, this may be an appropriate strategy.

2 Leave Internet business to resellers

Some companies prefer distributors to leave the Internet business for resales and not to sell directly through the Internet. How effective this strategy is depends on the existing distribution structure. It can be effective when manufacturers assign exclusive territories to resellers, since resellers can be restricted to either delivering only to customers within their assigned territory or they can be compensated through profit pass-over agreements if they are adversely affected. Any leads generated by the manufacturer's website are passed on to the appropriate regional reseller.

By contrast, for intensively distributed products where resellers have no assigned territories, resellers simply compete with each other as they would do in the normal, physical marketplace. The global nature of the Internet creates price transparency, which may conflict with differential prices charged by the manufacturer in various markets. Another limitation of this approach is that most consumers search for manufacturers' websites rather than resellers' websites. Inability to purchase from the manufacturer's website can be frustrating for the consumer and can result in lost sales for the manufacturer.

3 Leave Internet business to the manufacturer only

A third strategy for the manufacturer is to restrict Internet sales exclusively to itself. This strategy is only profitable if the manufacturer has a business model that is aligned with sales through the Internet. The business system of most manufacturers (such as consumer packaged goods companies) is not set up for sales to end users who place numerous small orders. Alternatively, by selling through the Internet a manufacturer may aim not to generate profits, but rather to learn about this new channel of distribution, collect information on consumers or build its brand. But regardless of a manufacturer's objectives resellers dislike having to yield the market space to manufacturers.

If the manufacturer uses this strategy it also risks channel conflicts, i.e. creating competition with its own customers (distributors). The PC manufacturer Compaq realised this when it struggled to exploit the Internet, because to do so properly would mean bypassing its distributors. For Compaq it was difficult to remit sales through the Internet without upsetting their distributors and jeopardizing their historically strong relationships with them. In order to limit the direct competition with its customers Compaq introduced a differentiated product line of PCs, Prosignia, for sales through the Internet (Kumar, 1999).

4 Open Internet business to everybody

The fourth strategy is to let the market decide the winners and open the Internet to everybody – for direct sales and resellers. Manufacturers who have ventured online, either through the third or the fourth strategy, usually sell at retail prices and/or provide only a limited line because of their desire not to compete with their resales. However, this limits the attractiveness of the Internet's value proposition.

Conclusion

The fear of cannibalizing existing distribution channels and potential channel conflict requires manufacturers to trade off existing sales through the traditional distribution network and potential future sales through the Internet. Unfortunately, history suggests that most companies tend to stay with declining distribution networks for too long.

16.7 Special issue 1: International retailing

In the continuing integration of the world economy, internationalization not only concerns advertising, banking and manufacturing industries, it also affects the retailing business. The trend in all industrialized countries is towards larger units and more self-service. The number of retail outlets is dwindling, but the average size is increasing.

However, retailing still shows great differences between countries, reflecting their different histories, geography, culture and economic development. The cultural importance attached to food in Italy provides an opportunity for small specialist food retailers to survive and prosper. In other developed countries, such as the United States, the trend is towards very large superstores that incorporate a wide range of speciality foods. The Italian approach relies on small-scale production by the retail proprietor. The US approach encourages mass production, branding and sophisticated distribution systems to handle inventory and freshness issues.

A consequence of the greater economies of scale and efficiency in US retailing is that the United States tends to have larger retail outlets and a smaller number per capita than other developed countries. Some industrialized countries do not have an extensive modern retail sector. Among them are Japan, France and Italy. Japan has more retail outlets than the United States with only half the population (Jain, 1996, p. 536).

Legislation

A major reason for the lack of growth of large-scale retailing in these countries is legislation. Compared to the United States, retailing in Europe and to some extent Japan is subject to rather stringent legislation. In order to protect the independent retailer in town centres legislation primarily targets competition, new shops, and days and hours of opening.

Legislative conditions differ across Europe. In the United Kingdom legislation is liberal, which explains the rapid development of large supermarkets in the 1980s and large specialized stores in the 1990s. In Italy, where legislation is much stricter, the opening of department stores and hypermarkets has been limited.

Legislation can hamper the development of some forms of retailing. Though France was one of the creators of the hypermarket (a giant market), the country passed a law regulating the establishment or expansion of retail stores in 1973. The effect of this law and similar laws in Italy is to allow existing retailers to protest against the establishment of any new, large-scale retailers in their area.

Internationalization of retailing

Both US and European retailers are internationalizing their business. Among large international US retailers are: 7-eleven, McDonald's, Pizza Hut, Blockbuster Video and Toys Я Us. Among the large international European retailers are IKEA, Benetton, The Body Shop and Carrefour.

The Japanese are relative newcomers to this internationalization of retailing, but they are getting deeply involved. One of the Japanese food retailers, Jusco, has supermarkets in Hong Kong, Thailand and Malaysia. South-east Asia seems to be the natural zone of influence for Japanese retailers, and they have spread throughout the region.

Despite the trend towards internationalization in retailing a prospective international retailer also faces some serious challenges and problems. The problems begin with the consumers. Retailers' performance in local markets is highly sensitive to variations in consumer behaviour. These are differences in consumer tastes, buying habits and spending patterns from country to country. Such differences have implications for a more differentiated merchandise offering along dimensions such as colour, fabric and site for clothing, and flavour for confectionery and snack foods.

Other problems that retailers will encounter when operating internationally include shortages of key resources such as land and labour, unfavourable tax and tariff structures, restrictions on trading hours and foreign ownership, and impenetrable established supplier relationships.

A case study of one US speciality retailer (Barth *et al.*, 1996) has pinpointed the problems of establishing a retail business in Europe. The reasons for the relatively bad financial performance in European retailing can be sought in the following factors:

- higher costs of acquiring real estate in Europe;
- more expensive labour in Europe;
- the complex legislation for establishing large retail stores in Europe.

Stages of internationalization

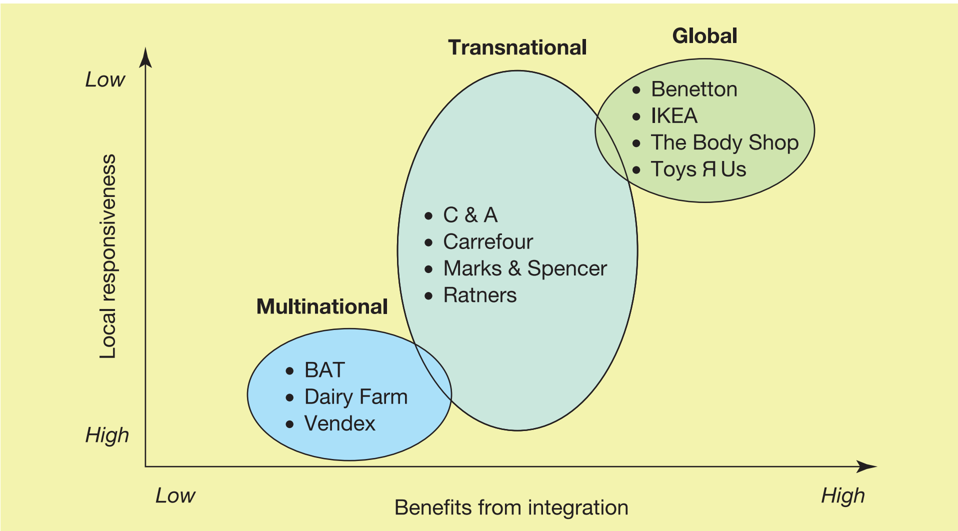
The 'stages' concept (the Uppsala school: see section 3.2) has been applied to depict the typical movement by retailers towards internationalization. Given the considerable risks and costs involved in expansion outside home markets, most have viewed the prospect with a degree of reluctance. Retail companies will typically move from reluctance to cautious expansion abroad, starting with the closest markets.

The internationalization of retailing has produced different styles of international operation, ranging from multinational to global (Figure 16.11). Global retailers such as Toys Я Us vary their format very little across national boundaries, achieving the greatest economies of scale but showing the least local responsiveness. Multinational retailers, on the other hand, operate as autonomous entities within each country. A middle course is termed 'transnational' retailing, whereby the company seeks to achieve global efficiency while responding to national opportunities and constraints.

Trade marketing

For too long manufacturers have viewed vertical marketing channels as closed systems, operating as separate, static entities. The most important factors creating long-term, integrated strategic plans and fostering productive channel relationships were largely ignored. Fortunately a new philosophy about channel management has emerged, but to understand its potential we must first understand how power has developed at the retailer level.

Figure 16.11 International development positions



Source: McGoldrick and Davies, 1995, p. 7.

Channel power
Ability of a channel member to control marketing variables of any other member in a channel at a different level of distribution.

International retailing
Worldwide tendency towards concentration in retailing, creating huge buying power in the big international retail chains.

Power in channel relationships can be defined as the ability of a channel member to control marketing decision variables of any other member in a channel at a different level of distribution. A classic example of this channel power is the amount of power wielded by retailers against the food and grocery manufacturers. As the balance of power has shifted, more merchandise is controlled by fewer and fewer retailers.

There is a worldwide tendency towards concentration in retailing resulting in international retailing. The concentration in the European food sector is most evident in the northern part of Europe. Since the mid 90s (when Table 16.3 was created) new players have arrived on the European grocery market, for example, the German discount-chain, Lidl, which is now second in the German discount-sector after Aldi. Lidl is also expanding to the remaining European area (e.g. to Scandinavia, UK and France). In the United Kingdom Tesco is now No. 1 and Sainsbury No. 2.

A consequence of this development is that there has been a worldwide shift from manufacturer to retailer dominance. Power has become concentrated in the hands of fewer and fewer retailers, and the manufacturers have been left with little choice but to accede to their demands. This often results in manufacturing of the retailers' own brands (private labels). This phenomenon was discussed in section 14.8.

Therefore we can see that traditional channel management, with its characteristics of power struggles, conflict and loose relationships, is no longer beneficial. New ideas are emerging to help channel relationships become more cooperative. This is what is known as 'trade marketing'. Trade marketing is when the manufacturer (supplier) markets directly to the trade (retailers) to create a better fit between product and outlet. The objective is to create joint marketing and strategic plans for mutual profitability.

For the manufacturer (supplier), it means creating twin marketing strategies: one to the consumer and another to the trade (retailers). However, as Figure 16.12 shows, potential channel conflicts exist because of differences in the objectives of the channel members.

Despite potential channel conflicts what both parties share, but often forget, is their common goal of consumer satisfaction. If the desired end result is to create joint marketing plans a prerequisite must be an improved understanding of the other's perspective and objectives.

Retailers are looking for potential sales, profitability, exclusivity in promotions and volume. They are currently in the enviable position of being able to choose brands that fulfil those aims.

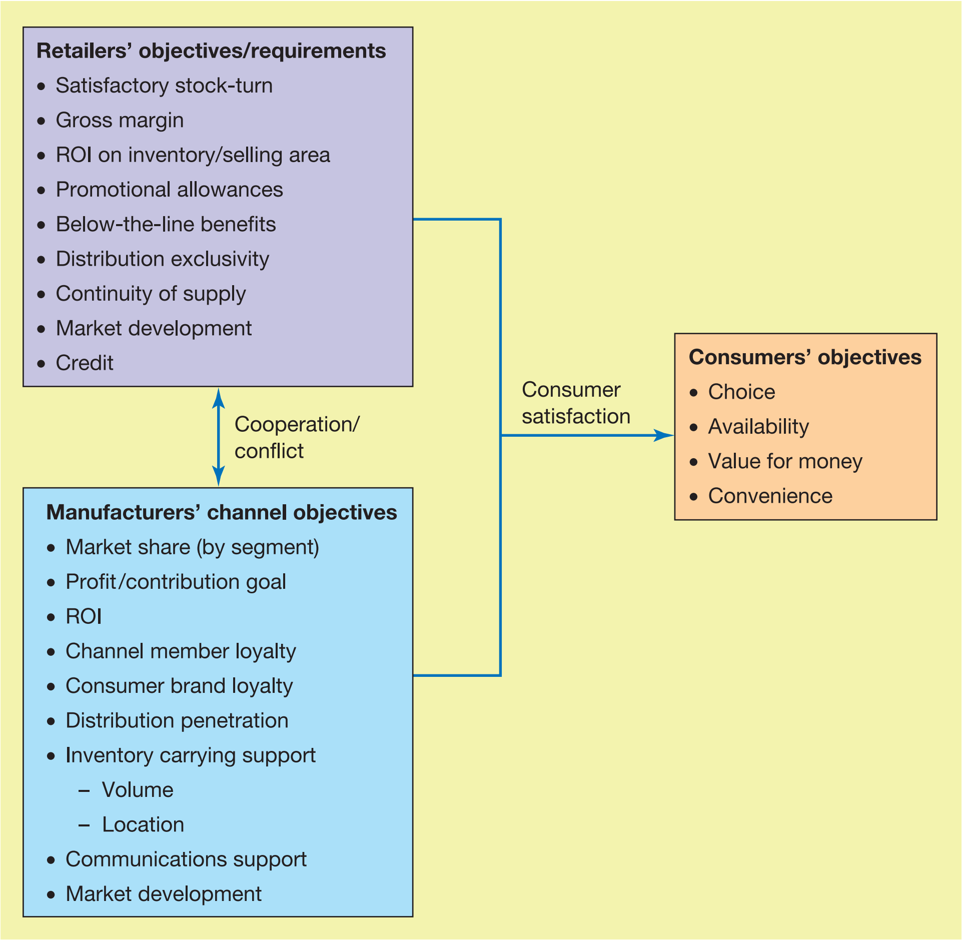
A private label manufacturer has to create different packages for different retailers. By carefully designing individual packages the manufacturer gains a better chance of striking up a relationship with the best-matched retailer.

Manufacturers can offer retailers a total 'support package' by stressing their own strengths. These include marketing knowledge and experience, market position, proven new product success, media support and exposure, and a high return on investment in shelf space.

If a joint strategy is going to be successful manufacturers and retailers must work together at every level, perhaps by matching counterparts in each organization. As a consequence of the increasing importance of the individual customer the concept of the key account (key customer) was introduced. Key accounts are often large retail chains with a large turnover (in total as well as of the supplier's products), which are able to decide quantity and price on behalf of different outlets.

Segmentation of customers is therefore no longer based only on size and geographic position but also on customers' (retailers') structure of decision making. This results in a gradual restructuring of sales from a geographic division to a customer division. This reorganization is made visible by creating key account managers (managers responsible for customers).

Figure 16.12 Channel relationships and the concept of trade marketing



Cross-border alliances in retailing

The focus of this section is alliances between retailers that are both horizontal (i.e. retailer to retailer) and also international, in that they cross the boundaries of nation states. Cross-border retailer alliances are emerging predominantly between western European retailers and can, in many cases, be interpreted as explicit responses to the perceived threats and opportunities of the EU internal market.

None of the cross-border alliances in Europe can be described as 'equity participating alliances', which include a cross-shareholding between members. None of the alliances involves the sharing of equity, but they all have a central secretariat with the function of coordinating operational activities – buying, branding, expertise exchange and product marketing.

Until now the range of activities performed by the secretariats of the alliances has been limited and excludes actual processing and central payments. The present advantage for an individual retail member in a cross-border alliance lies primarily in central purchasing from suppliers, where price advantages flow to all members, suggesting that the alliance is attempting to countervail the power of the manufacturer (supplier). Cross-border central buying can be a relevant starting point for both manufacturers and retailers attempting to move towards a pan-European supply network.

16.8 Special issue 2: Grey marketing (parallel importing)

Grey marketing (parallel importing) Importing and selling of products through market distribution channels that are not authorized by the manufacturer. It occurs when the manufacturer use significantly different market prices for the same product in different countries and mainly exits for high-priced, high-end products, like fashion and luxury apparel.

Grey marketing or **parallel importing** can be defined as the importing and selling of products through market distribution channels that are not authorized by the manufacturer. It occurs when manufacturers use significantly different market prices for the same product in different countries. This allows an unauthorized dealer (in Figure 16.13, a wholesaler) to buy branded goods intended for one market at a low price and then sell them in another, higher-priced market, at a higher profit than could have been achieved in the 'low-price' market. Grey markets mainly exist for high-priced, high-end products, like fashion- and luxury fashion apparel, watches, perfume etc.

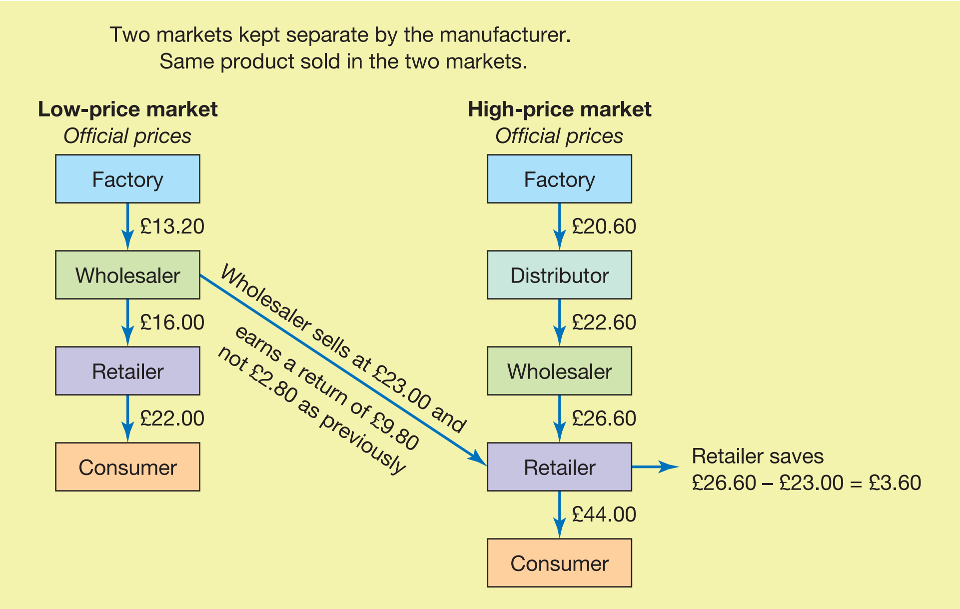
Grey marketing often occurs because of the fluctuating value of currencies between different countries, which makes it attractive for the 'grey' marketer to buy products in markets with weak currencies and sell them in markets with strong currencies.

Grey markets can also be the result of a distributor in one country having an unexpected oversupply of a product. This distributor may be willing to sell its excess supply for less than the normal margin to recover its investment. Other reasons for lower prices in some countries (which can result in grey marketing) might be lower transport costs, fiercer competition and higher product taxes (high product taxes put pressure on the ex-works price to keep the end-consumer price at an acceptable level).

The particular problem with grey marketing for the manufacturer is that it results in authorized intermediaries losing motivation. The grey marketer usually competes only on price and pays little attention to providing marketing support and after-sales service.

Grey markets are fed by many sources in the e-business. Perhaps the most common are authorized dealers who can make a profit, or at least minimize a loss, by selling to unauthorized dealers. The internet makes it easier for firms operating in grey territory

Figure 16.13 Grey marketing (parallel importing)



Source: Paliwoda, 1993, p. 300. Reprinted with permission from Butterworth-Heinemann Publishers, a division of Reed Educational & Professional Publishing Ltd.

to reach a wide range of customers. Companies can buy in bulk and resell to unauthorized distributors, a situation that has characterized the market for computer parts for some time. Sometimes a manufacturer itself will sell into the grey market as salespeople struggle to meet quotas or managers attempt to cover costs or make year-end sales goals (Antia *et al*. 2004).

Possible strategies to reduce grey marketing

Sometimes companies hope that it is a short-term problem and that it will disappear. Indeed it might be if the price difference is the result of the fluctuating value of currencies. At other times a more proactive approach to the problem is needed:

- *Seek legal redress*. Although the legal option can be time consuming and expensive, some companies (e.g. Seiko) have chosen to prosecute grey marketers.
- *Change the marketing mix*. This involves three elements:
  (a) *Product strategy*. This strategy is about moving away from the standardization concept (same product for all markets), and introducing a differentiated concept with a different product for each main market.
  (b) *Pricing strategy*. The manufacturer can change the ex-works prices to the channel members to minimize price differentials between markets. The manufacturer can also narrow the discount schedules it offers for large orders. This will reduce the incentive for intermediaries to over-order to get lower prices and later sell unsold stock on the grey market, still at a profit.
  (c) *Warranty strategy*. The manufacturer may reduce or cancel the warranty period for grey market products. This will require that the products can be identified through the channel system.

16.9 Summary

In this chapter we have examined the management of international distribution channels and logistics. The main structure of this chapter was given in Figure 16.1, and from the discussion it is evident that the international marketer has a broad range of alternatives for selecting and developing an economical, efficient and high-volume international distribution channel.

In many instances the channel structure is affected by external factors and it may vary from nation to nation. Physical distribution (external logistics) concerns the flow of goods from the manufacturer to the customer. This is one area where cost savings through efficiency are feasible, provided the decision is systematically made. The changing nature of international retailing influences distribution planning. During the last decade the balance of power (between manufacturers and retailers) has shifted in favour of the retailers. The manufacturer often has no other choice than to cooperate with large and increasingly concentrated retailers in terms of the 'trade marketing' concept.

A phenomenon of growing importance in international markets is the grey market, which consists of unauthorized traders buying and selling a company's product in different countries. Companies confronted with a grey market situation can react in many ways. They may decide to ignore the problem, take legal action or modify elements of their marketing mix. The option chosen is strongly influenced by the nature of the situation and its expected duration.

CASE STUDY 16.1

De Beers: Forward integration into the diamond industry value chain

Since the late 1800s the South African multinational De Beers (**www.debeers.com**) has regulated both the industrial and gemstone diamond markets and effectively maintained an illusion of diamond scarcity. It has developed and nurtured the belief that diamonds are precious, invaluable symbols of romance. Every attitude consumers hold today about diamonds exists – at least in part – because of the persistent efforts of De Beers.

Moreover, by monitoring the supply and distribution of diamonds throughout the world, De Beers has introduced and maintained an unprecedented degree of price stability for a surprisingly common mineral: compressed carbon. Such unique price stability lies within the cartel's tight control over the distribution of diamonds. De Beers' operating strategy has been pure and simple: to restrict the number of diamonds released into the market in any given year and to perpetuate the myth that they are scarce and should therefore command high prices.

De Beers spends about $200 million a year to promote diamonds and diamond jewellery. 'A diamond is forever' and the firm controls nearly 70 per cent of the rough diamond market.

De Beers controls a producer's cartel that operates as a quantity-fixing entity by setting production quotas for each member (as does OPEC). De Beers has successfully convinced the producers that the diamond supply must be regulated in order to maintain favourably high prices and profits.

During the early part of the last century much of the diamond cartel's strength rested with De Beers' control of the South African mines. Today the source of power no longer comes from rough diamond production alone, but from a sophisticated network of production, marketing sales and promotion arrangements, all administered by De Beers.

It is interesting to note that diamond prices have little or no relation to the cost of extraction (production).

Table 1 shows average or 'normal' price mark-ups on gemstones along the channel of distribution.

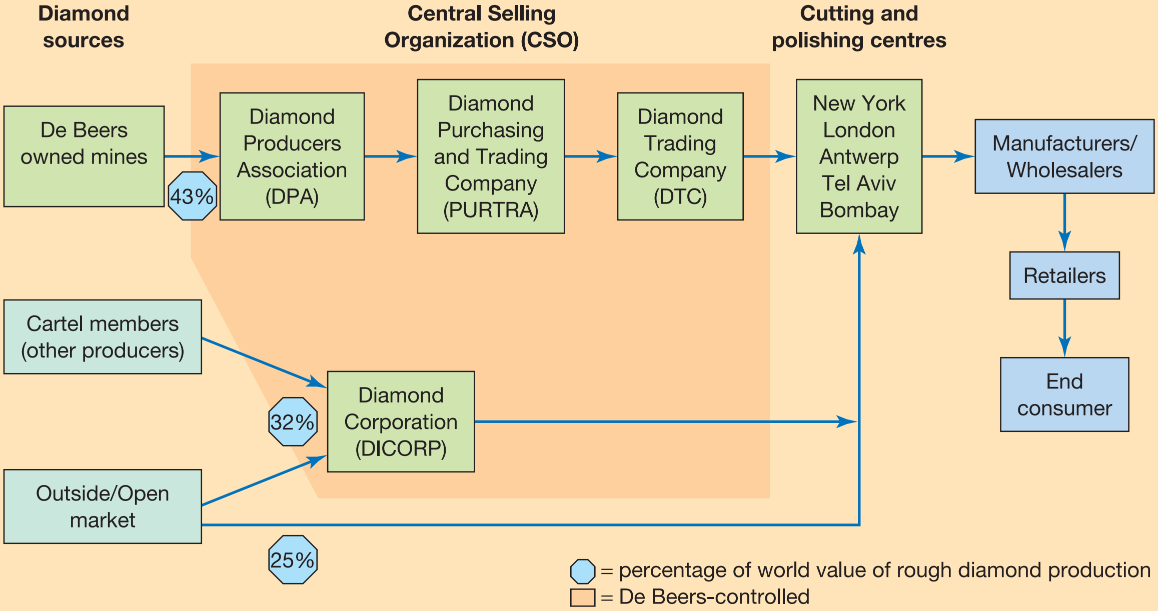
Table 1 Mark-ups on diamonds

Stage of distribution	Mark-up (%)	Average value of 0.5 carat gem ($/carat)
Cost of mining	–	100
Mine sales	67	167
Dealers of rough gems	20	200
Cutting units	100	400
Wholesaler dealers	15	460
Retail	100	920

Source: adapted from Ariovich, 1985 and Bergenstock and Maskula, 2001.

A diamond that may cost $100 to mine can end up costing a consumer $920 at a local jewellery store. Business cycles and individual commercial practices may positively or negatively influence these figures, together with the gemstone quality. Diamond sales, known in the trade as 'sights', are held ten times a year in London, in Lucerne, Switzerland, and in Kimberley, South Africa. The sales are limited to approximately 160 privileged 'sightholders', primarily owners of diamond-cutting factories in New York, Tel Aviv, Mumbai and Antwerp, who then sell to the rest of the diamond trade.

Figure 16.14 De Beers' diamond distribution



Sources: adapted from De Beers Annual Report and Bergenstock and Maskula, 2001.

Diamond output from De Beers' self-owned and self-operated mines constitutes only 43 per cent of the total world value of rough diamonds. Because it is not the sole producer of rough stones in the world De Beers has had to join forces with other major diamond-producing organizations, forming the international diamond cartel that controls nearly three-quarters of the world market.

De Beers has constructed a controlled supply and distribution chain whereby all cartel producers are contracted to sell the majority of their entire output to a single marketing entity: the De Beers-controlled Central Selling Organization (CSO) (see Figure 16.14).

The total rough diamond supply controlled by the CSO comes from three sources: De Beers/Centenary-owned mines, outside suppliers contracted to the CSO (cartel members) and open market purchases via buying offices in Africa, Antwerp and Tel Aviv (rough output purchased from countries that have not signed an agreement with De Beers). De Beers functions as the sole diamond distributor. In any given year approximately 75 per cent of the world's diamonds pass through the CSO to cutters and brokers.

The economic success of the cartel depends highly on strict adherence to their rules, written or unwritten. Clients who follow the rules are rewarded with consistent upgrades in the quality and quantity of rough stones in their boxes, while those who circumvent them find progressively worse allocations and risk not being invited back to future sights.

De Beers' 'forward integration' decision

Until 2001 De Beers concentrated on supplying its diamonds to brand manufacturers, such as Cartier. The core business of the De Beers Group remains the mining and marketing of rough diamonds. However, in January 2001 the De Beers Group, the world's premier diamond group, and LVMH Moet Hennessy Louis Vuitton, the world's leading luxury products group, agreed to establish an independently managed joint venture, De Beers LV, to develop the global consumer brand potential of the De Beers name.

LVMH Moet Hennessy Louis Vuitton is the home of premier brands in the categories of fashion and leather goods, watches and jewellery, wine and spirits, cosmetics and perfumes. LVMH will contribute with its extensive experience in both developing luxury brands and rolling out premium retail concepts.

The 'mother' company, De Beers SA, contributes to the joint venture with its over 100 years of experience in the form of technology and individual experts to allow for the selection of the most beautiful diamonds.

As part of the joint venture agreement De Beers SA has transferred to De Beers LV the worldwide rights to use the De Beers brand name for luxury goods in consumer markets. From now on, De Beers will design, manufacture and sell premium diamond jewellery under its own brand name. The diamonds bearing De Beers brand name will be sold exclusively through De Beers stores. De Beers has opened a flagship store in London (Oxford Street) and have plans for further openings in New York and Paris.

Source: information and news on www.diamonds.net.

Questions

1 What could be De Beers' motives for making this 'forward integration' into the retail and consumer market?

2 Is it a wise decision?

3 How should De Beers develop its Internet strategy following this 'forward integration' strategy?

4 Would it be possible for De Beers, with its branded diamonds, to standardize the international marketing strategy across borders.

CASE STUDY 16.2

Nokia: What is wrong in the US market for mobile phones – can Nokia recapture No. 1 position from Motorola?

Finnish Nokia is a world leader in mobile communications. Nokia connects people to each other and the information that matters to them with easy-to-use products like mobile phones, devices and solutions for imaging, games, media and businesses. Nokia provides equipment, solutions and services for network operators and corporations.

History

Nokia's roots go back to the foundation of the Nokia wood-pulp mill in 1865. It took its current form as a corporation under the laws of the Republic of Finland in 1967, upon the merger of three separate Finnish companies involved in a range of industries. In the 1980s, Nokia strengthened its position in the telecommunications, consumer electronics and personal computer markets. In 1982, it introduced the first fully digital local telephone exchange in Europe and the world's first car phone for the Nordic Mobile Telephone analogue standard. In the early 1990s, Nokia decided to make telecommunications its core business. As a result, it divested a number of other businesses, including paper, rubber, footwear, chemicals, cables, aluminium and television.

Nokia today

Nokia's principal activity is to provide mobile phones, broadband, IP network infrastructure and related services. It also develops mobile Internet applications and solutions for operators and internet service providers. Nokia is organized into four business groups: Mobile Phones, Network, Multimedia and Enterprise Solutions. As Mobile Phones account for the largest percentage of the total sales (61 per cent), this case will concentrate on that business group.

For the fiscal year ended December 2005 the Nokia Corporation generated total revenues of €34,191 million ($40,489 million). Profit before tax was €4,971 million ($5,887 million) for the year. At 31 December 2005, Nokia employed 58,874 people and operated fourteen manufacturing facilities in eight countries around the world for the production of mobile devices and network infrastructure.

Table 1 Nokia's ten largest markets (€ million in net sales) 2003–05

	2005	2004	2003
China	**3,403**	2,678	2,023
USA	**2,743**	3,430	4,488
UK	**2,405**	2,269	2,711
India	**2,022**	1,369	1,064
Germany	**1,982**	1,730	2,297
Russia	**1,410**	946	569
Italy	**1,160**	884	1,003
Spain	**923**	768	748
Saudi Arabia	**897**	750	547
France	**870**	604	867

Source: Adapted from www.nokia.com.

Turnover by region and country

Of the total turnover in 2005 Europe accounts for 42 per cent, Asia-Pacific 18 per cent, Middle East and Africa 13 per cent, China 11 per cent, Latin America 8 per cent and North America 8 per cent. The ten largest markets are shown in Table 1, together with the development in sales from 2003 to 2005.

From Table 1 it appears that the largest increase in net sales among the largest markets is found in China (68 per cent), whereas the largest decline (39 per cent) in net sales from 2003 to 2005 is found in the United States (39 per cent).

Nokia's position in the world market for mobile phones

In 2005 worldwide mobile phone shipments totalled 825 million units, a 17 per cent increase over the 707 million shipments in 2004.

As shown in Table 2, in 2005 Nokia ruled the world mobile handset market with a 32 per cent share, followed by Motorola (17.7 per cent), Samsung (12.5 per cent), LG (6.7 per cent), Sony Ericsson (6.2 per cent) and others (24.9 per cent). But in 2005, while Nokia's growth in market share was flat, Motorola's share was up 3 points from 13.8 per cent in 2004.

Nokia's crown is being challenged, meanwhile, as rival Motorola continues to ride high on the success of its thin phones, even as Nokia has yet to release a challenger with a similar degree of buzz.

Nokia's position in the US market for mobile phones

Back in 2004 Nokia was a market leader in the US mobile phone market, with a market share of around 30 per cent, and Motorola was No. 2 with a market share of 20 per cent. But since then the roles of Nokia and Motorola have been switched.

In 2006 Motorola led the US market with around 33 per cent market share, followed by Electronics Co. Ltd and Samsung Electronics Co. Ltd. Both stand a little ahead of Nokia, which has around 15 per cent market share. Interestingly, LG recently stole the No. 2 spot away from Samsung in the US market. Kyocera Wireless Corp., Sanyo Electric Co. Ltd, UTStarcom Inc. and Sony Ericsson Mobile Communications L.P. round out the top eight.

Nokia is certainly not satisfied with its US market position and is aiming to improve at targeting specific segments as it angles for a bigger slice of the North American market. In 2005, it conducted a worldwide segmentation study, trying to determine what various market niches wanted. The study included more than 60,000 hours of interviews conducted in 18 different countries (including the United States), leading analysts to expect more niche products from Nokia in coming years. The general perception by the US consumer was that Motorola had more features while Nokia was known as cheaper and reliable. It looks like people are willing to pay more for Motorola products.

Table 2 The world market for mobile handsets (2005)

Company	HQ country	Number of sold units (million)	Market share (%)
Nokia	Finland	264	32.0
Motorola	USA	146	17.7
Samsung	South Korea	103	12.5
LG Electronics Co.	South Korea	55	6.7
Sony Ericsson	Japan/Sweden	51	6.2
Others (e.g. Siemens, Sanyo Electric Co.)	Misc.	206	24.9
Total		825	100.0

Source: Adapted from Global News Wire (2006) and www.idc.com.

Distribution of mobile phones in the United States

In the United States there are two routes in the distribution of mobile phones: (1) from the manufacturer to the telecommunications retailer via a wholesaler; and (2) from the manufacturer via the carrier (i.e. wireless network operator) and its outlets. In recent years, the second route has become dominant; however, mobile phones are not sold under the carrier brand but under the manufacturers' mobile phone brands (Motorola, Nokia, Samsung, etc.). The manufacturers engage in sales promotion activities targetting the consumers for their own products sepatate from the services provided by the carriers.

Nokia's performance against Motorola in the US market is probably due to at least two important factors (Carson, 2006 and Dano, 2005):

1 Differentiation is the key in a market where nearly 80 per cent of consumers already own cell phones and many want distinctive features before being induced to switch. Motorola is clearly reacting to a lifestyle market opportunity. The thin phone by Motorola was designed to hit Nokia where it hurts (Nokia has long excelled at making candy bar-style phones).

2 More than 60 per cent of US mobile phone buyers selected a carrier first, and then chose their new phones from among the phones offered by that carrier. It seems that Motorola's surge in the US market could also be attributed to its extensive carrier agreements and relationships with the most important carriers, e.g. Sprint and Nextel Communications Inc. Some of Motorola's business goes through Verizon, the industry's second-largest carrier, but most of its business goes through many small carriers, scattered around the US market.

At a Nokia Conference in January 2006 the Finnish CEO Jorma Ollila was keen on changing the status quo in the US market. At the conference he said that Nokia aims to achieve the No. 1 position in North America: 'Being above 20 per cent market share is a good first step,' Ollila said. 'Next is establishing ourselves as the strong contender for the No. 1 position.' (Kharif, 2006).

Sources: Ewing, J. (2006) 'So-So Season for Nokia – The Finnish handset giant reported 2Q gains in sales, revenues, and earnings. But a slip in global market share dents its image', *Business Week Online*, Top News, 21 July; Global News Wire (2006) 'Nokia Market Share Growth Flat in 2005', The Indian Express Online Media Ltd, Financial Times Information Limited (IDC), 29 January; Carson, P. (2006) 'Nokia in hot pursuit of US market, global enterprise customers', *RCR Wireless News*, 15330796, 25(15), 10 April; Kharif, O. (2006) 'Nokia: Dialing North America', *Business Week Online*, 2 August; Dano, M. (2005) 'Motorola dominates US phone sales; Nokia in distant 4th', *RCR Wireless News*, 15330796, 24(46), 14 November.

Questions

1 Please prepare all illustrations of the distribution channels of mobile phones from Nokia to its end consumers in the United States.

2 What are the reasons for the global leadership of Nokia in mobile phones?

3 Why is Nokia the market leader in mobile phones on the world basis, but not in the US market?

4 What can Nokia do to recapture the No. 1 position in the US market?

VIDEO CASE STUDY 16.3

download from www.pearsoned.co.uk/hollensen

DHL

DHL International (**www.dhl.com**) specializes in cross-border express deliveries. DHL is the global market leader in international express, overland transport and airfreight. It is also the world's number 1 in ocean freight and contract logistics. DHL offers a full range of customized solutions – from express document shipping to supply chain management. DHL links about 120,000 destinations in more than 220 countries and territories and operates cargo airlines. The company provides Internet tracking and order fulfilment services.

Questions

1 What are the macroeconomic drivers for the growth of the logistic business?

2 What are the most important issues in keeping DHL's international competitiveness?

3 How can DHL be perceived as a local company in most countries of the world?

For further exercises and cases, see this book's website at www.pearsoned.co.uk/hollensen

? Questions for discussion

1 Discuss current distribution trends in world markets.

2 What are the factors that affect the length, width and number of marketing channels?

3 In attempting to optimize global marketing channel performance, which of the following should an international marketer emphasize: training, motivation or compensation? Why?

4 When would it be feasible and advisable for a global company to centralize the coordination of its foreign market distribution systems? When would decentralization be more appropriate?

5 Do grey marketers serve useful marketing functions – for consumers and manufacturers?

6 Why is physical distribution important to the success of global marketing?

7 Discuss the reasons why many exporters make extensive use of the services of freight forwarders.

8 Discuss the implications for the international marketer of the trend towards cross-border retailing.

9 Many markets have relatively large numbers of small retailers. How does this constrain the international marketer?

10 How is retailing know-how transferred internationally?

11 What services would the manufacturer like to receive from the retailer?

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