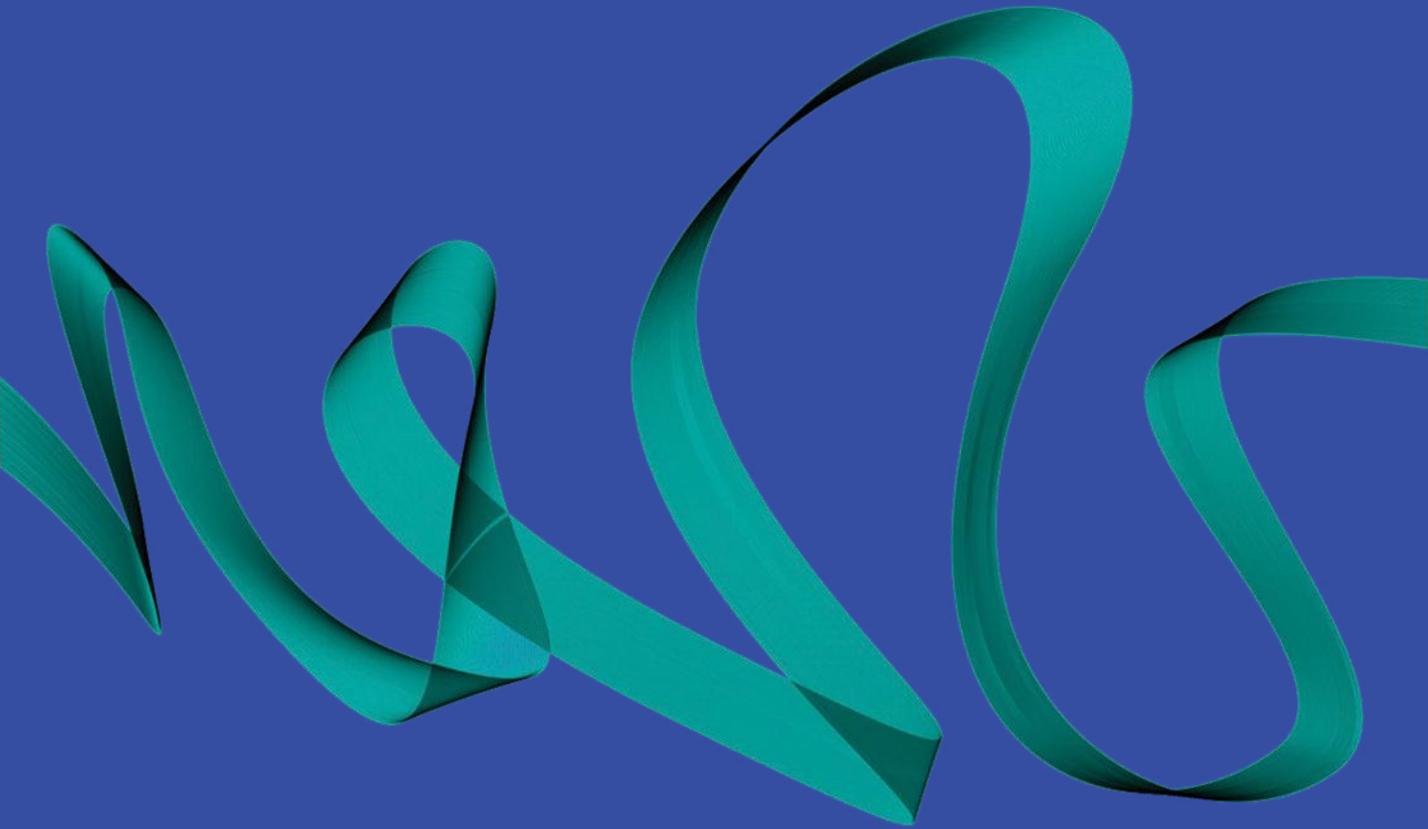




Achieving Successful Distribution In Emerging Markets



Ipsos Business Consulting

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This paper should be read in conjunction with Ipsos' Case Study "Distribution Channel Strategy Design". You can download the publication from our web site <http://www.ipsosconsulting.com/en/Ipsos-Publications>

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Executive summary

Manufacturers essentially determine their sales volume and success in a given market through the distribution channels they choose to sell products and services to clients. Many foreign companies operating in emerging markets, however, seem to lack basic knowledge about designing efficient distribution channels for these very specific markets, which limits their commercial potential.

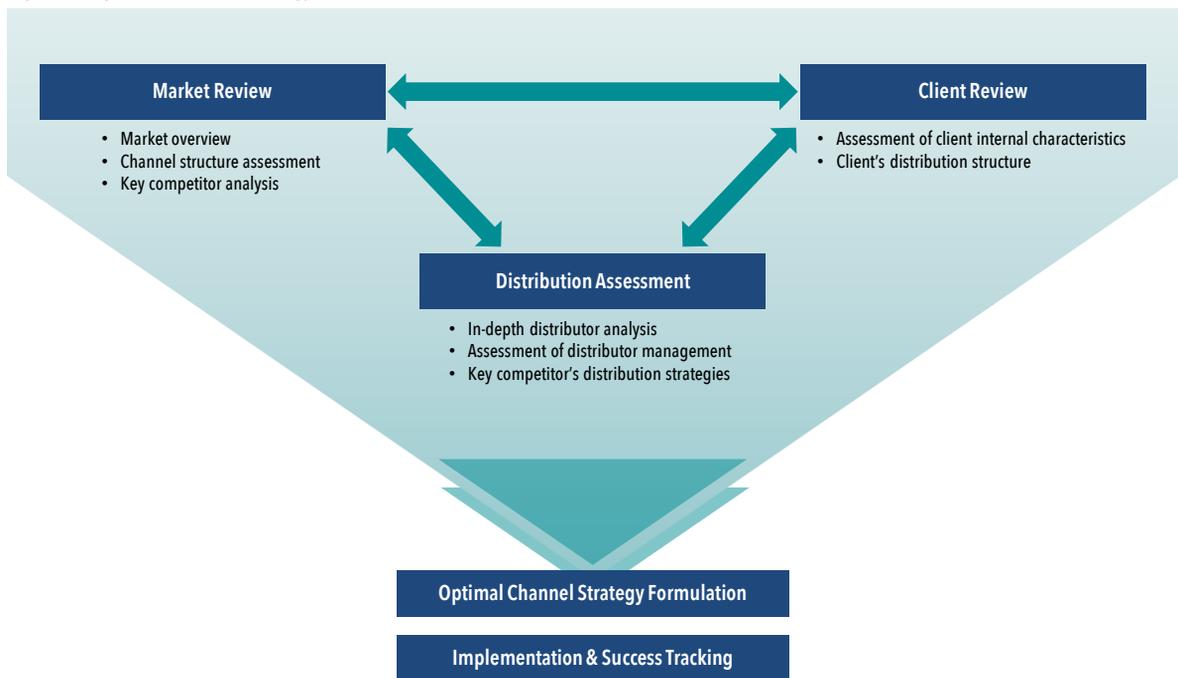
Ipsos has created a general model to help overcome this problem. It draws on the common characteristics of emerging markets to create a “best-fit” distribution strategy solution for companies, both new-entries and established manufacturers.

This model analyses key aspects of the market, distribution options and the company itself. Market analysis provides an

overview of the market in terms of size and development, assesses its channel structure and evaluates key competitors including their positioning, pricing strategy and sales breakdown. The channel section conducts in-depth analysis of distributors, assesses commonly-used management measures and examines the distribution strategies of key competitors. Client analysis assesses the company itself – both its internal processes and external market and distribution efforts – weighs up its strengths and weaknesses and determines the optimal channel strategy based on the client's individual needs, targets and resources.

These three elements combine to provide broad and deep insights that enable the client to better understand the market and provides them with an optimal distribution/channel strategy and a short-term model which makes the most efficient use of the company's existing resources to create effective distribution channels focused on delivering immediate sales growth.

Figure 1: Optimal Channel Strategy



Emerging market challenges

Manufacturers are too often uncommitted in the way they approach the matter of distribution, while at the same time lacking understanding about how to design and implement effective distribution strategies. Instead of basing their choice of channels on underlying factors, such as the company's business strategy or market conditions, distribution is commonly seen as little more than a utilitarian task. This commonly results in a distribution mechanism that is poorly aligned with the company's business strategy and operational and financial targets. The same goes for distributor management – companies with weak distribution strategies often put intermediaries in charge of selling their products without first understanding the basics of local sales and distribution, or how to manage and incentivise their agents.

Market fragmentation is another specific challenge many foreign companies face in emerging markets. Market landscapes in fast developing countries are usually characterised by highly uneven distribution of commercial buying power. Industrial markets are often located in special regions – so-called industry clusters or manufacturing zones – where there is high concentration of specific industries in a given geographical area but other target users or consumer markets remain widely dispersed.

The characteristics of emerging markets differ greatly from the more homogenous landscape within established markets, especially at the consumer level. Emerging markets typically feature regions with high consumer density and levels of commercial purchasing power that are comparable with that found in developed markets. However, they also feature larger underdeveloped areas with only a fraction of that purchasing power and a completely different, less-developed distribution landscape. This fragmentation leads to major challenges for manufacturers wanting to efficiently access each of these markets and sales territories.

Distribution strategy must therefore take heed of specific market and distribution conditions for the company to operate successfully and maximise sales revenue.

Understanding the distribution conundrum in more detail

Many companies entering new markets quickly learn that determining the best possible sales channels is a much harder task than first thought. Finding the right distribution partners and managing them successfully is key to delivering successful distribution that drives sales and increases a company's local success.

Selecting the best distribution channels is one of the most common and challenging problems for enterprises entering emerging markets. Companies must frequently reconsider how they approach the market and channels they use due to accelerating technological change, increased marketplace demands, more aggressive global competition and shifts in workforce and population demographics.

Poorly configured channels can result in lost sales and lower profitability. The importance of a coherent approach to distribution cannot be underestimated. However, all too often a company's distribution structure is the result of reactive, ad hoc decisions rather than being based on focused strategic thinking. Many companies rush into markets without even considering how distribution needs tailoring to the specific needs of the market. They make the mistake of thinking success is a matter of merely finding distributors who are willing to carry their products without even considering whether their business models or needs are aligned with the all-important matter of distributor management.

The simple reality that a distributor's characteristics play a major role in determining whether it can significantly contribute to a company's success is too often overlooked. Failing to consider this matter makes it even more unlikely that a company will develop smart incentives tailored to the nature of each distributor.

As all companies operate with limited resources, distribution strategy often becomes a trade off between matching internal objectives with external market conditions and accessing whatever distribution can be afforded with the available budget. An ideal channel strategy uses available resources (financial and workforce) to their full efficiency and establishes channels with capable intermediaries. Management develops a range of measures and incentives to motivate distributors and create as collaborative a relationship as possible. As a result the goals and objectives of the distributors are aligned with those of

the client company and incentives for distributors are structured to further improve the client's performance.

Designing a suitable distribution strategy is even more difficult in a foreign market, especially an emerging one, where the distance-to-market is long and local practices are largely unknown. Language barriers and cultural differences further complicate the search for appropriate distribution partners and can limit efforts to manage distributors.

The greatest challenge, however, is that posed by the fragmented consumer market. Better understanding the complexity of the specific markets, regions and the layers of distributor that serve them will help a company strengthen its competitive advantage by enabling it to more successfully reach target customers.

There is much data and analysis on fragmentation within emerging markets, especially China. It is a hot topic for consulting firms and a number of investigations in China have highlighted common challenges and solutions for a number of industries. These range from rating cities by their development, level of attractiveness and current and future economic potential to demonstrating the significant gap between the prosperous eastern coastal regions and undeveloped areas deep in mainland China and farther out west.

Order in the chaos?

Distribution in emerging markets tends to be more chaotic than in developed countries. Most smaller-sized distributors only operate with a rudimentary infrastructure, resulting in a huge gulf between them and the capacity of their larger counterparts. This means a client will have to devote much more management effort to ensure these smaller distributors are utilised to best effect. Large distribution companies have their fair share of problems too. They are more often than not unable to service all regions of the country they operate in. Furthermore, the total number of distributors in developing countries is generally very high as smaller distribution firms have yet to be consolidated. Distributors can therefore be found in all conceivable sizes with every business model imaginable. Many carry products from across a range of industries.

Most large distributors in emerging markets carry a large number of different brands and rather than specialising in specific industries, they instead try to serve as many companies as possible. This leads to inventory overcrowding where many distributors expand their portfolio to a level where they can no longer adequately represent individual brands and products. It also results in them focusing on selling goods with the highest profit margin and neglecting those which offer lower commercial returns. Companies that want to operate

successfully in such emerging markets need to understand what motivates local distributors and develop their channel-management and incentives accordingly.

A fundamental understanding of distributor business models and different ways of managing them is required to create well-functioning incentives. Different management methods interact with distributor characteristics in various ways. The results can be both positive and negative for client companies. Some combinations create large incentives for the distributor to sell the client's product while others lead them to neglect it. This can determine whether a company succeeds or fails in the market. Finding suitable management measures for a distributor is likely to result in them becoming a highly effective partner that is able to efficiently address all market opportunities. A weak combination might lead to a situation which actively undermines the company's business performance.

For example, a company could offer its distributor support in the form of concrete sales leads generation and marketing programs, thereby helping them to increase sales. While this sounds good on paper, if the distributor carries competing brands within the same market segment that enjoy higher margins, the general nature of the company's support could help the distributor more effectively market and sell its competitors' products. This demonstrates how a lack of understanding can devastate a company's performance and prevent firms from operating successfully or efficiently.

Generating understanding

To resolve this problem companies must take a coherent approach to creating their channel strategy by considering all relevant issues ranging from market conditions and the distribution landscape to the characteristics of the company itself. While this is easier said than done, these aspects directly affect optimal distribution and sales channel strategy.

Key questions which companies looking to optimise their distribution and channel strategies should ask include:

- How complex is the market's channel structure?
- What needs to be done to ensure a certain level of control over product distribution?
- What types of distributors can sell my products, what is their expertise in this specific product segment and what are the motivations behind their actions?
- What do I want to achieve in this market, what is my overall business strategy and what resources are available to develop channels and establish contractual relationships?

Answering these questions will require a significant investment of time and effort, however it will pay dividends by enabling a company to find the right balance between what it wants to achieve and what is possible with the resources at hand.

A successful channel strategy for emerging markets must be based on the unique characteristics and specific market conditions. The key factors here are the fragmentation of the consumer market with its highly varying consumer buying power and the different industrial clusters and manufacturing zones for companies operating in industrial markets. Knowing where your target consumers are located (whether they be standard consumers or industrial clients purchasing industrial goods) is essential for a successful approach to distribution.

Ipsos solutions

Ipsos has created practical tools to help overcome these essential problems that provide clients with a tiered approach for devising optimal distribution channel strategy based on a comprehensive analysis of underlying factors and conditions.

The model consists of analysing three distinct areas – the target market, the distribution landscape and the company itself – which when combined will help determine distribution strategies in terms of their relative strengths and weaknesses.

Each stage involves an extensive analytical description of their respective areas. The market analysis answers the questions of what the key figures and key trends of the market are in regards to units in the market, new sales per period, numbers of sales and purchasing points (depending on market type) and other key statistics. Furthermore, it describes how the market is structured, how many layers it contains and assesses close competitors in terms of their positioning, price strategy and sales.

The distributor analysis dissects the market by distributors, their business models and regional tiers. Secondly, it describes common ways for managing these distributors and which combinations of management and distributor characteristics will most likely affect the company's likelihood of success. The last section outlines existing distribution structures of comparable firms that serve as practical examples of distribution solutions to be followed or avoided.

The client analysis explains the company's business scope, business strategy and product positioning, as well as how these factors influence channel design. The client is further evaluated to assess their current situation, what distribution structures they are capable of implementing and their sales, image and distribution goals. The final aspect of this analysis is optional and models the client's distribution structure to allow for a gap

analysis between client and competitor distribution structures.

Analysis of the three areas provides key insights which are summarised in the fourth step along with their implications for the client. This allows clients to better understand the market by laying out the most common distribution channel practices in the market along with their pros and cons. An optimal channel strategy is proposed which draws on key market, distribution and client insights. It pairs common distributor types with management measures and effective incentives for driving sales.

A "first-steps" model provides a starting point to the transition between the client's current status and the desired optimal distribution strategy. For new entrants to a market this includes the very first steps needed to establish a successful short-term distribution structure that provides the foundation for future implementation of the proposed optimal strategy. Companies with established distribution channels are provided with "first-steps" for changing their structure according to the optimal channel strategy. In this case, existing contractual relationships and key challenges posed by current distribution practices are considered to determine which changes should be prioritised to find an approach that facilitates the smoothest transition possible. This short-term model, aimed at achieving the best trade off between available resources and market opportunities, focuses on delivering improved performance in the near-term.

Along with these suggestions, Ipsos provides step-by-step implementation support to clients and is able to track the success of the new channel establishing process using key metrics of distribution channel performance.

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