

Independent distribution: an approach for multinationals in the overseas market. Impact of market size in segmenting distribution for the electrical appliances market.

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Abstract

Multinational companies nowadays are acting globally as they attack markets worldwide. In order to deploy their strategy those companies need to build support and front office structures. In a dynamic environment in which markets face volatility the required structures can harm the performance of the subsidiaries. An alternative to mitigate such risk arise by outsourcing activities in the supply chain offering opportunities for local entrepreneurship. The next step to act at country level is transferring the activity to an independent distributor that will follow the strategic guidelines set by the multinational and coordinated from a wider area regional headquarters.

Keywords: Market independent distribution, distribution segmentation, multinationals overseas.

1. Introduction.

As markets from the end of 20th century are becoming global multinationals need to get established in those markets that will enable them to achieve the required volumes to guarantee a profitable operation and acquire a global share of market (Ekeledo, 1998). For that purpose companies require either establishing directly and setting up a certain structure in each of the countries or finding a partner or a number of partners acting as distributors that will facilitate the presence of the company in that market (Ayal, 1979). It is also possible that some activities that normally should be accomplished internally could be outsourced as a measure to reduce the potential impact of market volatility and at the same time keeping a slimmer structure.

Due to the cyclic dynamics of the economy the profitability of the overseas operations face variations depending on the specific cycle the area is involved (growing or declining). Thus structures need to adapt fast and the slimmer the structure will be the better the company will care its profitability. IT systems enable to deliver part of the services globally without the need of establishing those activities at country level. Under these circumstances there is the need of establishing a network that will be able to deliver the same services that formerly multinationals were supplying. In case not it would mean that the market would accept to destroy part of the value added and that customers would be satisfied by a price reduction since those services will not be delivered accepting them as superficial and not necessary free their business development. Mature markets does not commonly accept service reduction, but

in the contrary face that customers continuously demand more and better services to be delivered by their supplier.

As a consequence of previously stated an enormous bulk of opportunities arise for entrepreneurship ventures in the country. Even if the sales activity and the delivery of the results remain inside the multinational part of the supply chain activities, back office and other different services that companies deliver to their customers can be outsourced in order to simplify the local structure and the communication with the group headquarter. Those activities can be efficiently handled by local companies and individuals that have had access to the multinational culture, policies processes and procedures will definitively face a competitive advantage to interact with the multinational.

We then accept that the market dynamic and maturing trend of those markets drive the activity towards an environment in which services and adding value through the chain grows (Burstein, 2003). Market volatility and increase of competition oblige multinationals to rationalize their structures and develop business models sustainable on the different scenarios (Caplin, 2006). A local structure reduction and a set up of shared services centres to take care of different markets-countries finding synergies and certain economies of scale is a solution to this paradox. Nevertheless, there are specific activities that will require local support and the decision whether will be part of the subsidiary or transferred to the partner (Oum, 2004).

In order to validate the feasibility of the hypothesis that considers a model in which the multinational will not be present but appointing a local distributor and coordinating the activity from the global headquarter a field survey has been conducted. The sample taken entail companies acting as distributors in the different assessed markets. Markets involved are air conditioning, renewable energies, heating, electrical appliances, industrial cooling, and ventilation.

2. Subsidiaries establishing overseas. The present model.

Factors to support decision making (Aguilera, 2002) between direct distribution and independent distribution are going to be analyzed: socio-economical, market size, logistics capillarity, government rules, maturity of the market (Helsen, 1993). All those factors have an impact or will influence positively or negatively in the model that better fits every market in every area of the world. A market in which socio-economical situation is unstable a direct business development will be hardly sustained by the multinational as business volatility will be high and sizing the structure will be difficult to correctly dimension. A very small market can be easily approached but a heavy business structure will not be able to capture the added value such market is offering. Geographical deployment of the country and the logistics will affect the number of branches required for developing and servicing the business as far as assessing the number of warehouses distributed throughout the region.

Commonly bigger markets are approached by multinationals through their own structure. Getting supported either by a regional headquarter or by a global headquarter, policies, procedures and culture are transmitted to the subsidiaries established on each of the countries. Through such standards in finance, marketing, operations, sales, local companies will report to headquarters and will enable the consolidation of each of the topics according to the regional level. Those countries setup a structure locally that enables the transmission of results and performance and that guarantees that information will be understood according to the same format in each of the countries around a regional headquarter.

The local structure varies based on the culture of the organization and the different players in the market to be cared of. Some have heavy finance departments as accountability reporting.

In the case of electrical appliances analyzed in this paper sales support activities required as well a heavy structure as the market is largely atomized. This large capillarity of the business will demand a sales force able to cover every channel and every local region. Together with the sales force, operations will need to support such structure with the corresponding order handling and administration centre. Additionally a dedicated marketing department with specific customer and product support will be required that will enhance the capability of the customer base to include the product portfolio throughout their applications. As part of the supply chain the after sales activity is implemented. A number of technicians with know-how on field failures and service assistance are required. Strongly linked to the after sales activity remains the spare parts service to support the units installed in the field.

As a result of these different stages in the added value chain the structure of multinational corporations takes a considerable size that gets affected by the proper size of the markets they are involved in as much as in the volatility those market experience. Fixed costs allocated to the local companies become so heavy that profitable operations can only happen in emerging markets with high margins, or in markets with substantial size permitting to absorb or to share them. As a consequence of those heavy sales structures appears an additional burden which is the one to make it aligned with the policies and procedures established by the multinational at headquarter level. For that purpose specific activities which are not linked with the local activity are implemented. Those increase the force and resources to dedicate to different tasks as reporting and procedures in line with the corporation. This requirement constrains the model as local competitors do not require part of those structures for reporting purposes and therefore they gain competitiveness versus international players. The model experience as well that decision making process for local companies joined to multinational corporations takes longer than local companies do.

2.1. The alternative of outsourcing activities in the supply chain.

When the market size or the complexity of the market hinders the complete setup of a subsidiary at country level then an alternative arise as setting part of the whole activities in the supply chain outsourced (Davies, 2007).

Actually every task in the supply chain can be outsourced, but specially those which do not belong to the core business of the company. Going throughout the supply chain appears a bulk of tasks that can be externalized. Indeed this option is a clear source of opportunities for entrepreneurship development in which an important success factor takes place. The opportunity of a previous experience as employee within the company contributes in having access to the culture of the company, as far as their policies and procedures. This can be critical within a multinational environment.

In the finance chapter activities like accounts receivables posting, accounts payables posting, invoice issuing, part of the treasure tasks, taxes and collection can be considered to be externalized.

In the marketing chapter most of the activities can be externally executed. That is the case for the agency relationship, events preparation, document and catalogue edition, creativity for the literature, benchmark competition, press relationship and image.

Logistics activities are commonly carried out by experts more than keeping it in house. The opportunity of savings in this area due to economies of scale and knowhow is very high for transport and also for the warehouse activity. Transport companies are able to offer more resources than the multinational itself. Fleets will be higher since the trucks will be shared to supply service for different companies. Experience on designing the most efficient routes will help to drive costs low and through the long term agreement transferring that saving to the

multinational. In the case of warehouse and handling experience curve is also to the utmost importance. Additionally in a wide extent logistics can be part of the variable costs instead of being in the fixed cost area. By this mean the effect of sales volatility gets diminished.

After sales is another area in which outsourcing becomes a natural mean to deploy the geographical support without overweighting the overhead structure. The need of a fast a service to the site and the requirement of a close and direct contact with the issue oblige either to build an organization with a capillary structure of field technicians throughout the region or to organize an outsourced service coordinated internally by the technical area manager or the technical manager. The field technicians coordinated by those technical managers care the commissioning and start up of the units if required.

Presales activities or sales support are feasible to be outsourced too. In the contrary of the activity previously mentioned this activity is normally centralized and thus makes the control and the productivity much more efficient than after sales activity.

Order reception and customer correspondence is as well an area of outsourcing. Depending on the complexity of the product range offered by the company and the variety of the customer base the typology of the call centre varies. In case the product range is short, easy to differentiate, with no many complications and the customer base short in number or not very professionalized a call centre with low learning curve could be established. In case the product range is wide, with lot of complications and a customer base professionalized the outsourcing of the call centre will be harder to setup or at least a limitation will be recommended in the rotation of the personnel selected. Product range complexity plays a negative influence in the definition of the call centre outsource model. The complexity of the product range plays against the outsourcing of the task in the supply chain. In the contrary the diversity and size of the customer base plays in favour of outsourcing.

Of course the sales activity is also a section in the supply chain that can be outsourced through agents either partially or totally. It is quite common to apply the outsourcing in those areas that turnover is not big enough to let the layout of the multinational own structure.

We understand that whenever outsource is applied the knowhow of the activity should remain within our own company and the control level is critical for a successful deployment. Key performance indicators (KPI) needs to be set in advance to correctly measure the alignment with targets and strategies and need to be monitored frequently in order to identify and establish corrective actions if misleading or misalignment happens. In the contrary some activities could be out of control and the impact will directly affect to the multinational but not to the outsource company.

We confirm then that most of the activities in the supply chain can be externalized. The outsourcing strategy needs to be aligned with the strategy of the company. In the definition it is required to establish which portion of an activity will be outsourced or if any of those in the supply chain should remain internally as part of the core business.

The effect of a positive potentiality of outsourcing is the source of the base model proposed in this paper. Whenever the business model permits to outsource a high number of activities the transfer of the model is also transferrable to a total extent into an independent distributor. Indeed independent distribution model is the outsourcing of all the activities in the supply chain at a country level.

When the factor that drives the outsourcing is the volatility of the market it will be critical to identify metrics that will evolve following the trend of the turnover in order to digest big changes in the market. The internal knowhow is as well fundamental to setup outsource

services that should have a lower cost, fixed or variable, than keeping them inside. In the contrary the model will be heavier and not competitive against the local payers.

As part of another study the entrepreneur opportunities offered by outsourcing the different activities in the supply chain can be studied in order to understand which factors should happen to make that challenge successful. As some authors have written in the entrepreneurship environment big multinational are not only the pure contributors to innovation but more and more in the last decades the innovation is coming from small and middle enterprises.

2.2. The alternative of independent distribution.

Markets influenced by high capillarity in their distribution, high number of direct customers, reduced technological components, market volatility and with constrained returns are potential businesses to intermediate and accept a model of independent distribution. These variables will influence in a very complex model for the local company joined to a multinational corporation. Additionally, in a measurement period of several years markets evolve up and down and structures associated to the model observed suffer as do not have the flexibility and the prediction capability to adapt to those variances. These variables then drive the business development to an alternative model based on deploying at local level a slim structure that will have the responsibility to coordinate one or some intermediaries that will take care of the market. These intermediaries act as independent distributors and will establish their resources fully dedicated to the activities transferred by the multinational or in combination with other activities developed by them.

The market development through independent distributors supports a slim structure at country level as sales, presales and after sales structure is focused on the support on a few numbers of customers (Hennart, 1998). The multinational company at local level just needs to coordinate a few numbers of distributors in case the activity has not been transferred solely to one independent distributor. Some part of the activities above mentioned disappears for the local company of the multinational corporation and some others get reduced significantly. Reporting and consolidation remains but complexity becomes minimal. Logistics are totally simplified as normally drop shipments will be executed to those distributors that intermediate the activities. Sales force structures now does not need to cover a wide geographic area nor a long number of customers. Profiles trend to a key account sales force more than a heavy sales force structure. Concerning the back office operation, it is almost the same, due to the number of transactions is much lower than a model based on direct distribution.

When business model selected becomes through independent distribution it will be necessary to clearly map the market and identify those channels in which the players are present and which market are coping. Based on that, one or several partners will be selected as independent distributors. Based on Delta Model, distributors should be segmented within the different customers perspectives explained in the triangle, system lock-in, best product and total customer solutions (Hax, 2009). System lock-in strategy is not always easy to achieve as the company should own some process, product or solution that becomes dominant in the market and that will impel the market to use it as market standard. Actually the classic approach was to build strategies in the cost leader model or in models focused in the product the company sells though the differentiation strategy. These two models are the basic strategies established by Michael Porter in Competitive Strategy. Currently those strategies are not easily sustainable as market dynamics obliges to continuously innovate from a product perspective and in case the company looks for cost leadership it will push the company to continuously be the better price. Nevertheless in the company portfolio there will always be a segment of our customer base that will base its strategy in those two approaches. Total

customer solution strategies are focused to deliver enhanced product features by not purely looking at the product but better understanding a long run relationship with the customer and understanding their needs. The relationship with the customer opens by delivering services that the company has easier access and that make product offering more attractive. The company becomes a shuttle of products and services that correctly conglomerates the proposal and delivers in a continuous feedback process to adjust to customer needs the total customer solution building loyalty with the customer.

Those companies acting as independent distributors will design a portfolio that will be the base of their strategy and that will entail the service level they will deliver to their customers (Nambisan, 2002). There are several factors to decide in the business model strategy like those segments in which they are present, in each of them they decide whether they use a multi brand strategy or only one brand will be offered to each of the channels or segments involved. Within the product portfolio the company offers it is required to establish if a multi-tier strategy is applied or only one level is deployed in each of the product range the company participates.

Once the channels, brand portfolio and product range has been selected the company decides in which area they are involved and how is the deployment; central logistic distribution or regional distribution to approach to the market capillarity. Fixing a specific area with a product offering, distributors will be differentiated by the service level. Activities mentioned in the added value chain for local companies as part of multinational corporations become a part of the distributor strategy deciding whether that activity is part of their offering or not. Distributor has the alternative to offer as part of their service to their customer base a product support office, design software, after sales support, extended warranty period to the norms regulating that market, shipment to the job site, specific financing tools, and coop advertisement.

Distributor delivers to the customer part of the activities than a direct model will be granted by the local company joined to the multinational corporation (Martinez, 2002). This approach, together with a multi segment and multi brand strategy is the starting point of the total customer solution proposition that an independent distributor can offer to their customer base.

3. The market case of electrical appliances.

In the case of electrical appliances business there are different channels in which distributors are operating. The different sectors involved in the distribution of electric appliances are electrical distributors, heating and gas appliance distributors, residential air conditioning distributors, industrial cooling distributors, general contractor distributors and the retail channel.

The common model of customer segmentation is based on price. Nevertheless there are factors that make the product more attractive for distributors and that increase customer bonding due to product requirements (Craft, 2004). Nevertheless, it is common in this segment that products are based on market standards driven by market leaders (Gallagher, 2007).

As mentioned in previous chapter the different activities that the distributor will deliver segment the players (Dukes, 2006). Product training, training in new technologies, design for a specific customized product to be marketed solely by the distributors, product support, financing, product availability, coop advertisement to reinforce distributor image, prescription, product design based on distributors needs in a long run, access to global

markets via multinational network, after sales support, access to multinational suppliers for financing tools, skills training (sales management, leadership,...) (Davies, 2004).

Logistics for the distributor is a key success factor as the nature of their model is an intermediary between the multinational and the professional that acts locally (Windahl, 2004). As part of the strategy the distributor will select the level of the inventories in house and number of warehouse spread through out its influence area.

4. Field survey to distributors in the market with potentiality of becoming independent distributors.

The distribution market for electrical appliances as previously mentioned is integrated in different sectors: electrical distributors, heating and gas appliance distributors, residential air conditioning distributors, industrial cooling distributors and general contractor distributors. Each of those segments has a comparable business model even each of them has specific characteristics.

We have selected the population of residential air conditioning and industrial cooling distribution. A qualitative survey with open questions has been conducted by two surveyors to 15 companies in this sector all around Spain. Estimated duration of the surveys has been around an hour to an hour and a half each. This segment could contain a total of 50 companies all around Spain. The purpose is to assess up to which extent an independent distribution model, in which multinational would have low or none local presence in a volatile market, would be feasible. The surveyed personnel of the distribution companies were the general managers and in some of them also the sales manager and the purchasing manager participated.

The questions placed go from the global to the specific and from the past and present to the future outlook.

The distributor starts describing his business and in which segment they are involved. As mentioned they are in the heating, air conditioning and industrial refrigeration business. Then they go to their vision of the current status of their business and the segment they are involved. Once this has been described they are asked a set of questions about which is the demand of their customers, the reasons why a customer should buy them instead their competition. The reply to this question is quite aligned between all the surveyed participants. Customers are asking them different services as product availability and wide range. Always they ask that they should be competitive but again they turn to technical advice, continuity, long shop opening periods. When they are specifically asked about what customer demands they refer to the good, the nice and the cheapest but when the question is focused in the reason they sell to that customer it is never replied supported by the price. They argue as mentioned that they deliver service, transport, availability, technical advice, support in the start up, agility, proximity, continuity.

Next stage in the survey is to identify reasons why installers buy to multinationals instead of local distributors when this happens. Again the price is a common reply together with the glamour of buying the multinational. Price gap is identified around 3-8% and is agreed makes just sense when value of the project is material. The price difference is so narrow that the services and added value delivered from a distributor will clearly benefit even the higher price difference in a single deal. Again the service the local distributor deploys plays a key success driver to retain the business with the installer and becomes an advantage compared with the multinational.

The arguments the local distributors use to select a supplier are partially integration in their inner strategy. They look for reliability, image, trust of doing business, product quality, product availability, finance, projected profitability, number of appointed distributors in an area rationalized, after sales support, the power of the brand.

Local distributors align in a quite extent the reasons and installer selects them with the reasons they will select to add to their product basket a specific brand. The support local distributors ask for is technical advice around the product range offering and the power of the brand itself in the area they are present.

About future trends they observe a potential integration of a group of distributors within the different sectors mentioned. They consider that current channels of distribution as different local wholesalers, small installers and big installers will remain even if the small installers will definitively move to supply from local wholesaler or distributor than from the multinational corporation.

Finally all would positively accept and don't find constraints in taking care of an independent distribution when the multination would establish their regional headquarters at a higher regional level than the country size.

Companies surveyed are long life distributors that have been involved in the business for a longer period than 10 years. They are concerned about the situation the market face in the period the survey has been carried out. The scenario is within a 3 years lasting crisis in the sector and for the time being without a clear picture of the end. That environment is not only applicable to the specific segment analyzed but also to the general environment of the country. Under those circumstances it is a common reply the confidence on the continuity of the activity of distribution at a country level and the certainty that model should evolve to make it sustainable to a large size distributors supporting wider areas.

5. Conclusion.

Most of these above mentioned tools are transferrable to the distributor/s to add value for their customer base. By this mean the distributor will become a local platform delivering to its customer base not only its own skills but also the access to the know-how of the multinational as far as the access to suppliers linked to the multinational.

Distributors based in their customer base should assess their service level but also their product portfolio. Product offering could approach different markets as electrical appliances, gas furnaces, heating equipment, air conditioning equipment, auxiliary components for those appliances. The distributors will add to its strategy whether they will have a tiering strategy and different suppliers on each of the families or a selective number of brands in their portfolio.

The survey carried out supports the high potentiality of the model explained in the paper as a possible solution to fix the uncertainty, dynamics and size of specific markets that behave with a standard at country level.

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