Distribution Channel Strategy Design

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contents

This paper should be read in conjunction with Ipsos' Research Note "Achieving Successful Distribution in Emerging Markets"

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Case study – Distribution channel strategy design

The client company is an American automotive care and maintenance products manufacturer. Its two major brands are among the most recognised auto care appearance and fuel additive brands in the world. Brand A's product line consists of protectants, wipes, tyre and wheel care products, glass cleaners, leather care products and washes designed to clean, shine and protect interior and exterior automobile surfaces. Brand B's product line includes oil and fuel additives, functional fluids and automotive appearance products. The client's brands target the car maintenance and beauty segment.

The company is a global business generating net revenue of US$300m with products available in more than 40 countries. It is a relatively new player in the Chinese market and sells its products under the two above-mentioned brand through a single distributor. The client recently opened an office in Shanghai in order to establish an in-country presence. As of 2011, combined sales of the client's products in China were 1.5m yuan (approximately US$240,000).

Ipsos Business Consulting was commissioned to conduct market research of the Chinese automotive maintenance and beauty market in order to provide the client with a comprehensive market entry strategy.

1 Market evaluation

1.1 Market analysis

China's overall automotive maintenance and beauty segment was estimated at almost 10.8bn yuan in 2011, comprising 6.5bn yuan for service activities and 4.3bn yuan of product sales. It posted steady annual growth of more than 20% each year from 2009 to 2011 (see Figure 1). Ipsos Business Consulting forecasts this growth trend will continue in the near term.

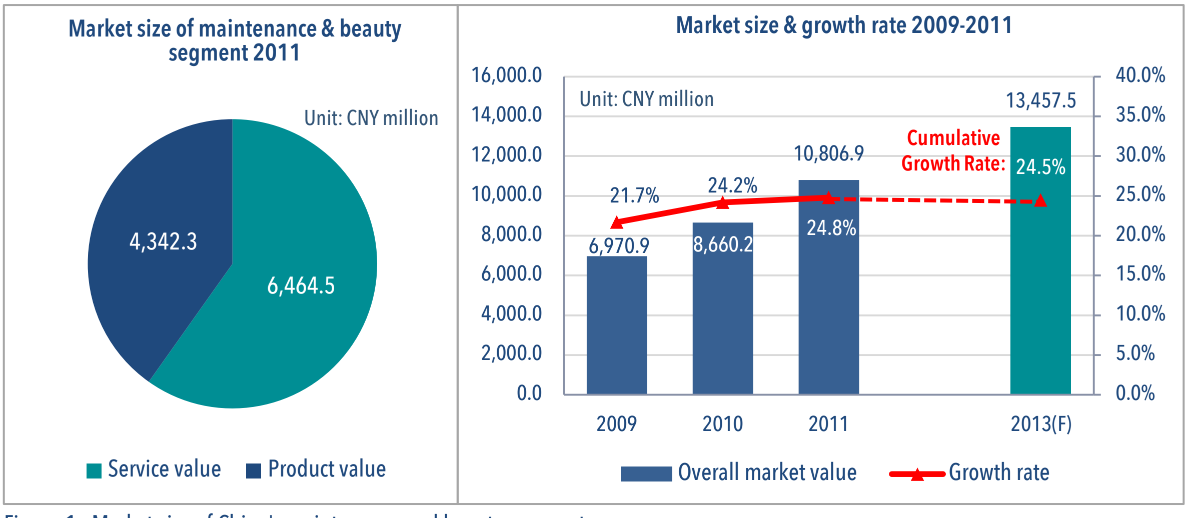


Figure 1 - Market size of China's maintenance and beauty segment

Fuel additives, car air fresheners and accessories are the top three product categories by sales value in China and account for about 60% of total market share (see figure 2). At the other end of the spectrum oil additives, protectants and wipes represent just one per cent.

Individual product categories drive the segment's development. Annual growth rates for cleaning products are very high, with general accessories growing 23%, washes 20%, cleaners and degreasers 22% and wipes 25%. Beautifying products show similar trends for the most part. The substantial market for air fresheners is expected to grow 30%, wax and polish 25% and the wheel and tyre segment 15%, with protectants trailing at 11%. The performance of maintenance products varies slightly with fuel additives and functional fluids demonstrating strong growth potential (30% and 35% respectively) while growth in oil additives has almost stalled with sales forecast to rise a mere 2% this year.

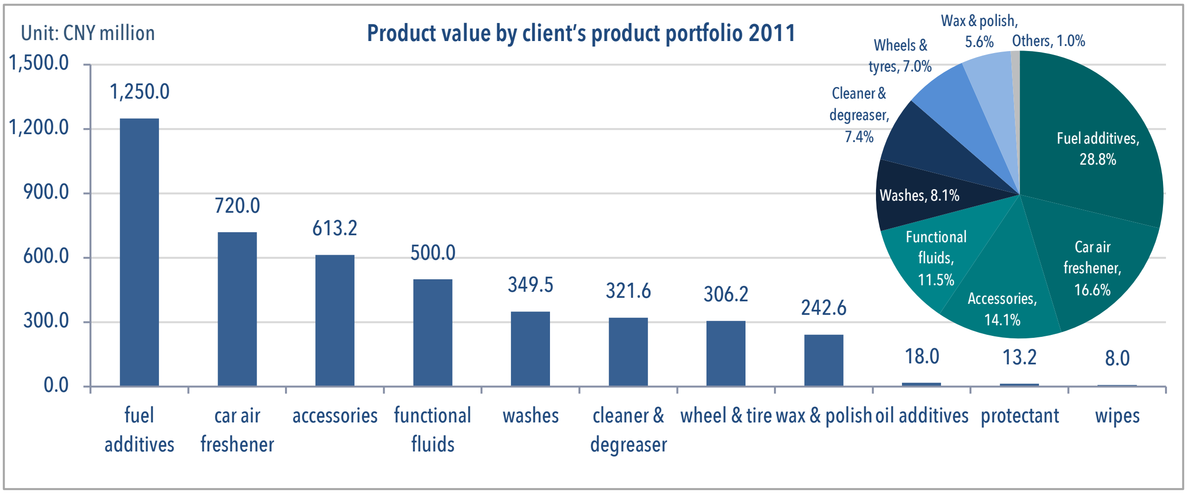


Figure 2 - Market size by client's product portfolio

The number of passenger vehicles varies greatly from region to region as shown in figure 3. The vast majority of China's passenger vehicles are found in regions located along the eastern seaboard. Western provinces had less than one million units, according to 2011 figures. The top six provinces, which are all located along the east coast, account for more than 47% of the total passenger vehicle market by volume. Central regions account for about one-quarter of the market share with the vast western provinces chalking up just 8%.

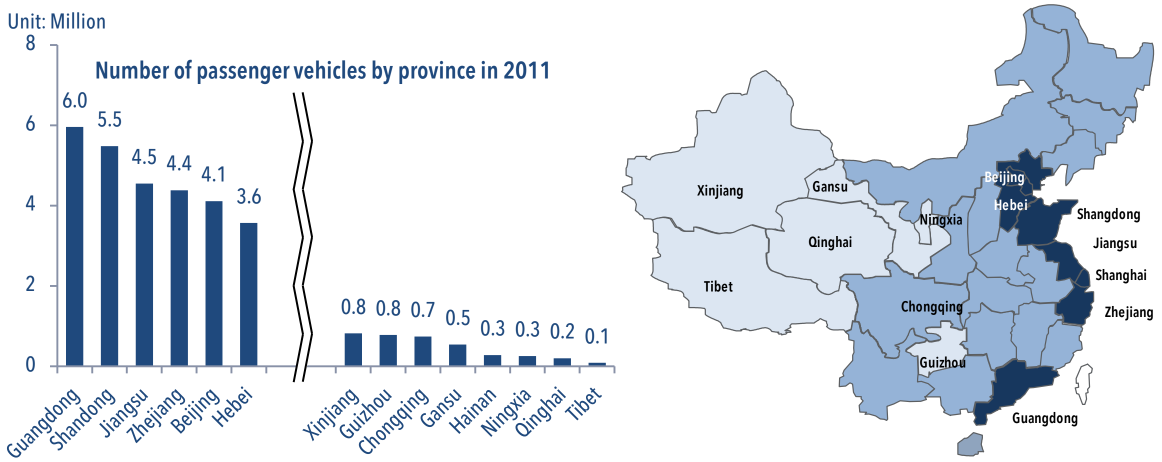
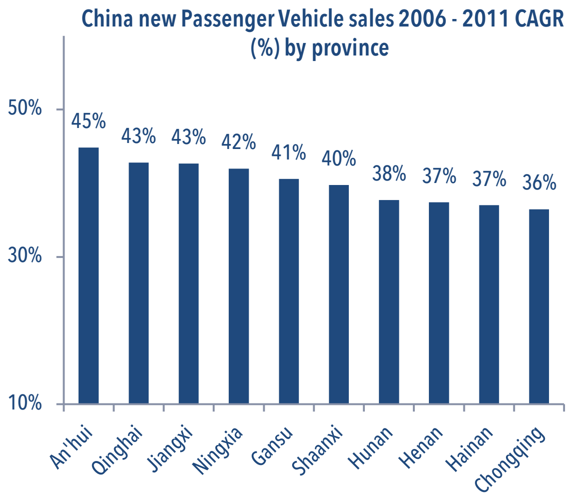


Figure 3 - Existing passenger vehicle units by provinces

Ipsos Business Consulting conducted a social listening study which garnered further insights on end consumer location. It analysed the most popular online forums and internet sites related to China's automotive aftercare market for mentions of certain product groups and car maintenance products as well as identifying where forum users lived. More than half of the content was posted from seven provinces/municipalities, namely Guangdong, Jiangsu, Beijing, Shandong, Hebei, Zhejiang and Shanghai. These findings are in line with other analyses of the passenger vehicle market.

Figures for new private vehicle sales by province from 2006 to 2011 (see figure 4) show the mid-west enjoys higher growth rates of more than 35%, when compared to more mature markets in east China where growth has slowed to around 25% due to higher levels of development and increasingly congested traffic. While the volume of sales in the mid-west is lower than in traditional markets, the region is evolving into an area of increasing importance for companies, especially in terms of future growth potential.



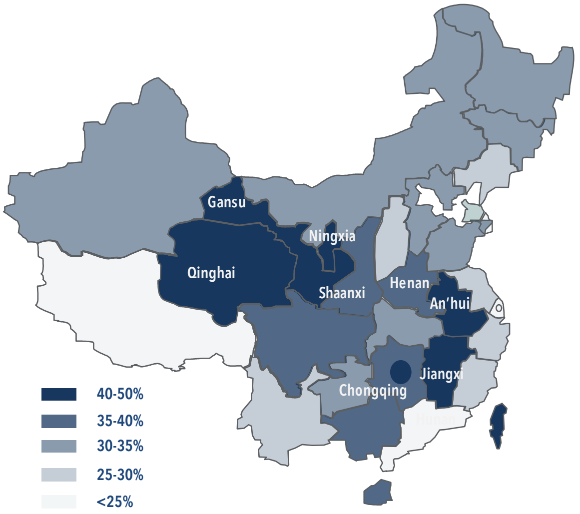


Figure 4 - Passenger vehicle sales growth rates by provinces

China's maintenance and beauty segment comprises nine core after-market channels: large and small workshops, fast fitters, beauty shops, 4S-shops (sales, spare parts, service and survey), gas stations, accessory shops, supermarkets and online shops. Large and small workshops, as well as fast fitters, are primarily focused on the independent aftermarket.

Large workshops often have fixed corporate clients. Repair services are the key driver in this channel where beauty and maintenance only plays a minor role in the business. Small workshops, which rarely belong to a chain or have a brand name, provide simple maintenance, car wash and beauty services. Fast fitters are mostly independently owned and operated, or local chain shops, focusing on fast-fit services such as filter, engine oil and tyre replacement. The main business of beauty shops is automotive beauty and beauty-related services. A franchise model is becoming common practice for this type of shop. 4S-shops are authorised by original equipment manufacturers (OEM) like Audi or Shanghai Volkswagen and offer services such as car sales, repair and maintenance. Gas stations proved to be an interesting case during this study as they sell fuel-additive products in addition to their bread-and-butter refuelling business. Accessory shops mainly sell "do-it-yourself " (DIY) retail products, some also offer car wash and simple repair services. Such businesses are increasingly combining with fast fitter or beauty shops to extend their service offering.

Supermarkets and online retailers are significant emerging sales channels for automotive beauty and maintenance products. These channels tend to concentrate on consumer-focused DIY products as they both operate exclusively in the retail space. Online channels can be either officially authorised shops on Tmall.com (China's largest online B2C platform for branded goods) or an online portal for distribution firms who sell other manufacturer's products. Store numbers and trends vary greatly from channel to channel as China and its automotive aftermarket continue to develop and evolve.

Traditional workshops are either stagnant or declining, providing a stark contrast to the boom in newer channels which continue to rise in popularity. Smaller workshops are falling by the wayside as they cannot provide the diverse range of services demanded by most customers these days. They also lack the quality provided by other channels. As a result, many smaller workshops are transforming into fast fitter and beauty shops which are proving more resilient to the changes in the market even though their numbers are also declining, all be it at a slower rate.

Large workshops are also being affected by the changing face of the auto aftercare market. The segment is currently in stasis, with the number of stores remaining roughly the same as it was in 2009. Fast fitters, beauty shops and 4S-stores exhibited the fastest growth from 2009-11 with 20%, 25% and 33%, respectively. Their higher-end position increasingly makes them a key part future growth plans for companies operating in the sector.

Gas stations have not been analysed in terms of their quantitative development. The lack of exact figures for the number of supermarkets prevents detailed trend analysis. There was also little or no concrete data for the other channels. Accessory shops, for example, often exist in combination with beauty shops or fast fitters. The nature of online shops makes it difficult to break them down into specific end channels. What can be said, thanks to a qualitative assessment, is that both accessory shops and online channels are expanding rapidly.

Table 1 provides an overview of the different end channels.

Channel	Stores (est 2011)	Growth (no. of stores)
Small workshops	100,000	-12%
Large workshops	60,000	0%
Fast fitters	24,000	+20%
Beauty shops	50,000	+25%
4S-stores	20,000	+33%
Gas stations	100,000	/
Accessory shops	/	Emerging channel
Online shops	/	Rapid expansion
Supermarkets	/	/

Table 1 - End channel sales points and trends [1]

Ipsos Business Consulting did not conduct a general competitive environment analysis, it instead focused on in-depth analysis of specific competitors which were identified together with the client. All foreign brands active in the Chinese market today are seen as the closest competitors. Section 1.3 provides detailed analysis of these companies with section 2.2 focusing on their distribution strategies.

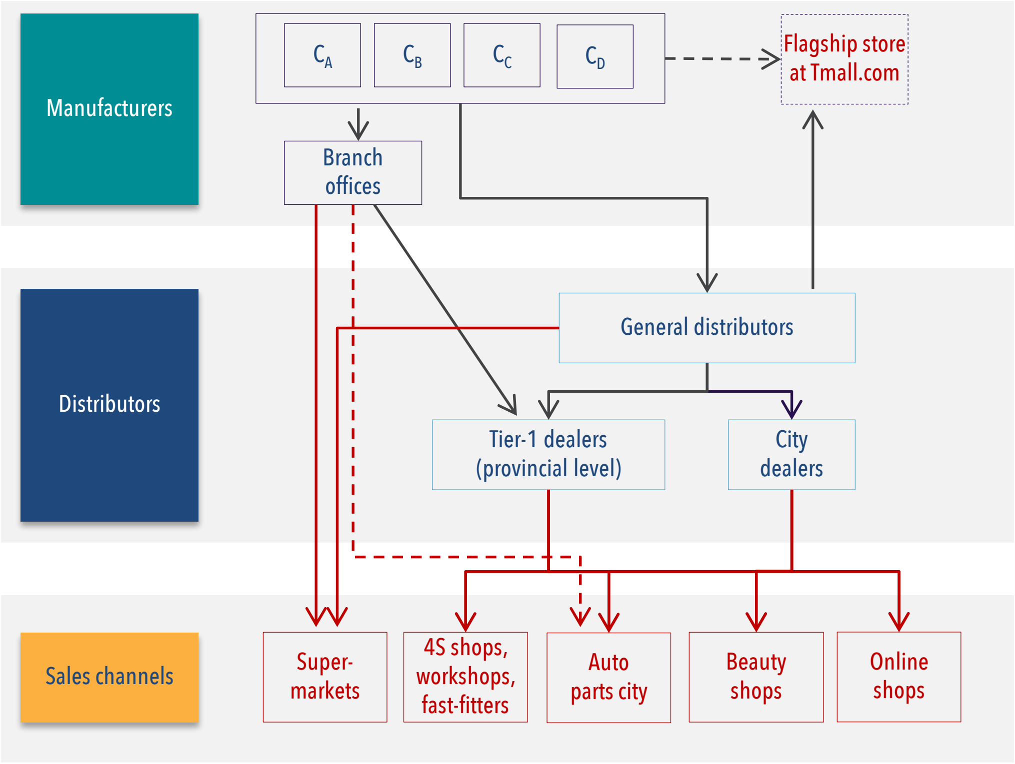
1.2 Channel structure

Distribution layers

The Chinese automotive beauty and maintenance product market has a moderate number of layers between manufacturers at the top and consumers at the bottom. Products are sold directly to end consumers (car owners) via e-commerce channels, as well as to numerous types of repair and maintenance shops (workshops, fast fitters, beauty shops, 4S-shops, gas stations and accessory shops) where they are used to service customers' cars or those displayed for sale purposes. Traditionally, the majority of product sales have been made through repair and maintenance channels as the DIY market in China is underdeveloped compared to the US and Europe.

Manufacturers are both local Chinese companies and foreign firms, the latter of which imports most of their products. Foreign manufacturers do not usually have a physical presence in the Chinese market, instead they typically work through one to a few general distributors. However, general distributors vary greatly in the capacity, quality and penetration of their distribution. A typical model uses tier-1 dealers or city-level dealers to access most end channels while selling direct to supermarkets and flagship stores on Tmall.com (see figure 5).

In a few cases, foreign manufacturers operate headquarters and branch offices in China and sell to tier-1 dealers directly without using an intermediate general distributor. They sell to all end channels through distributors save for supermarkets, which are the responsibility of branch offices in each respective region, and flagship stores on Tmall.com which is dealt with by the headquarters. Figure 5 gives an overview of these approaches.



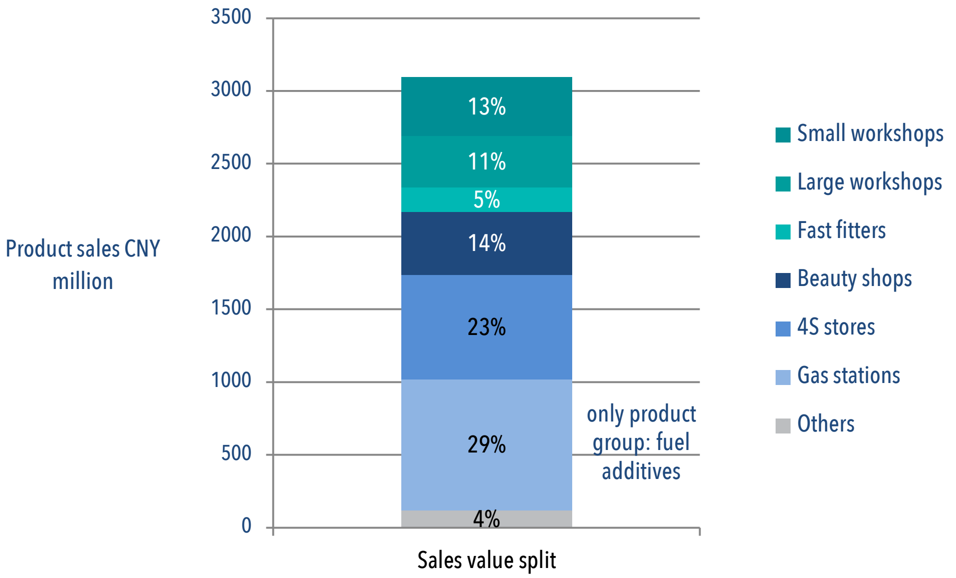
Note: 1) Auto parts city includes wholesalers and automotive accessory shops
2) Dashed arrows indicate less common connections

Figure 5 - Layers in Chinese maintenance and beauty segment

End channel analysis

End channels have been analysed according to their share of product sales and as a proportion of the total value of products flowing through them. This, combined with the number of sales points within each channel, helped the client company focus on essential and important channels that should be focused on. Only seven of the 11 product groups within the client's product portfolio were analysed – washes, cleaners and degreasers, accessories, wax and polish, wheels and tyres , protectants and fuel additives. The remaining four product categories were not included in the analysis because they were mostly distributed online (air fresheners) or through gas stations (oil additives and functional fluids).

Figure 6 provides a comprehensive overview of the 2011 sales value distribution between the seven analysed product groups by end channel. Gas stations were the main driver of overall sales value but only carried one of the seven products (fuel additives) while the others offered multiple products



Note: 1) The following end channels are not included: online shops, supermarkets and accessory shops
2) The following product groups are not included: functional fluids, air freshener, oil additives and wipes

Figure 6 - Sales value distribution by channels (2011)

End channel sales value split shows the product value by end channels by year and the average store contribution for each channel by year. An evaluation of all product groups (outlined in table 2) shows that three channels stand out for their combination of high total sales value, high average contribution and channel growth: large workshops, beauty shops and 4S-stores.

End channel		Small workshops	Large workshops	Fast fitters	Beauty shops	4S stores	Gas stations	Others
Points of sale		100,000	60,000	24,000	50,000	20,000	100,000	
Washes	Product value: CNY 349.5 million	91	108	59	45	49		0,5
Cleaner & degreaser	Product value: CNY 321.6 million	109	42	42	109	19		
Accessories	Product value: CNY 613.2 million	178	129	43	178	49		31
Wax & polish	Product value: CNY 242.6 million	17	73	22	73	58		
Wheels & tyres	Product value: CNY 306.2 million	6	3	3	18	239		37
Protectants	Product value: CNY 13 million				7	6		
Fuel additives	Product value: CNY 1250 million					300	900	50
Air freshener	P. value: CNY 720 million	Mainly sold through online shops, supermarkets and accessory stores						
Wipes	P. value: CNY 8 million	Mainly sold through beauty shops and accessory stores						
Oil additives	P. value: CNY 18 million	Mainly sold through gas stations and 4S stores						
Functional fluids	P. value: CNY 500 million	Mainly sold through 4S stores, workshops and fast fitters						
Total product value/year (CNY million)		401	355	169	431	720	900	118
Ø Total POS contribution/year		4,010	5,900	7,050	8,600	36,000	9,000	/
Channel development/year		↘ -12%	→ 0%	↗ +20%	↑ +25%	↑ +33%	/	

Table 2 - End channel sales value split (rounded figures)

4S-stores account for about 720m yuan with a very low number of stores, just 20,000 across the country. This leads to an average yearly contribution of 36,000 yuan from each 4S-store. Large workshops and beauty shops contribute sales of 355m yuan and 431m yuan, respectively. With nearly three times as many stores in the Chinese marketplace than 4S-stores, 60,000 and 50,000, each store generates average sales of 5,900 yuan per year for large workshops and 8,600 yuan per year for beauty shops. Beauty shops and 4S-stores also boast an impressive expansion rate which suggests sales generated through these channels will continue to increase for the foreseeable future. Ipsos Business Consulting's analysis has identified these three channels as the most important within the Chinese automotive care and maintenance product market and recommends they are prioritised.

Fast fitters may contribute higher point of sales (POS) revenue per year (about 7,000 yuan), however, they are a less attractive overall channel due to their relatively total product sales of 169m yuan per year – less than half that of large workshops and beauty shops. However, fast fitters are rapidly expanding which makes them worth considering as a second priority.

Small workshops are appealing with total product sales of 401m per year. However, with roughly 100,000 stores, this channel features a far higher number of sales points than other channels, except for gas stations, rendering it with the lowest POS contribution of all channels included in the analysis. It is also the only channel to post a decline in sales revenue in recent years and its store numbers are expected to contract further in the years to come.

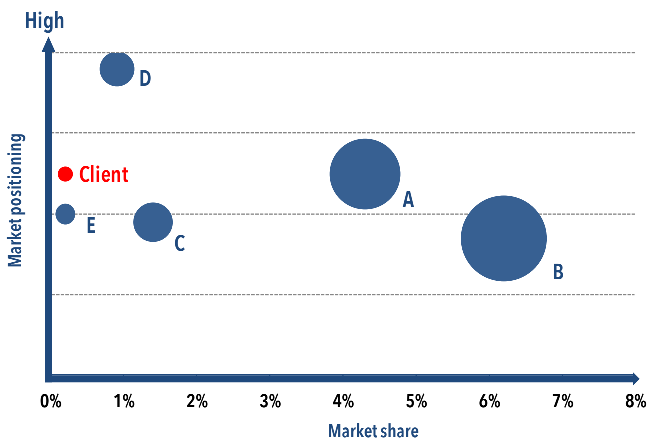
Gas stations have to be considered separately from other channels as they only sell one relevant product group, fuel additives. This singular focus, however, makes gas stations a vital channel for fuel additives as they generate sales of 900m yuan, more than 70% of this group's total yearly sales of 1.25bn yuan.

Accessory stores were not included in the analysis as they are often combined with other shops.

Online shops and supermarkets are emerging as channels for the distribution of DIY products and will play a bigger role in the future. They are not currently conducive to concrete analysis due to online sales being too difficult to assess in terms of total sales value. Competitor analysis, however, found both channels to be important.

1.3 Key competitor analysis

The client's main competitors in the Chinese maintenance and beauty market are competitors A, B and C. For the most part they share the client’s product portfolio and are similarly positioned in terms of price. Competitor D, however, operates exclusively within the very high-end price segment. Competitor E only sells air fresheners. In terms of price position the client, as a middle- to high-end brand, is most similar to competitor A. In the market, however, the client is perceived as an exclusively high-end brand since its low-end products are priced higher than those of its competitors. Figure 7 gives an overview of the client’s position compared to its direct competitors.



Competitor	Market position	Product value (2011)
A	Middle-high	CNY 185 million
B	Middle	CNY 269 million
C	Middle	CNY 58.7 million
D	High	CNY 45 million
E	Middle	CNY 15 million

Figure 7 - Competitor's market share and positioning

The client is on exactly the same level as competitor A with regards to its maintenance product group. Other competitors cannot be compared because they do not carry this product group. For beautifying products the client is competing in the same price segments as competitor A for the wheel and tyre and protectants product lines. In the wax and polish segment the client only operates in the lower price range while competing products retail from the same level up to three times the price. The cleaning product group is different with the client having a noticeably higher price than the washes products of competitors A and B. The client provides too narrow a price range for cleaner and degreaser products. Figure 8 shows the client's pricing compared to its competitors for two product groups.

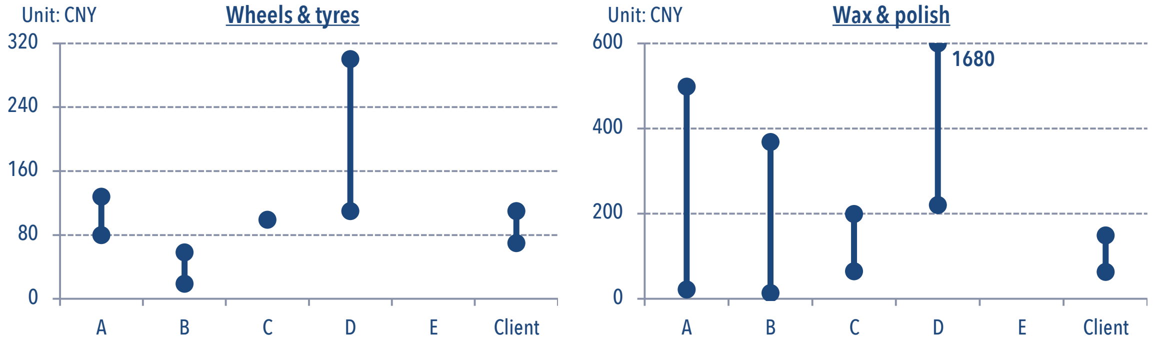
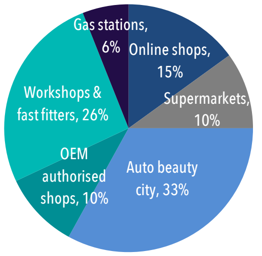
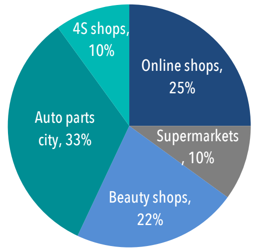
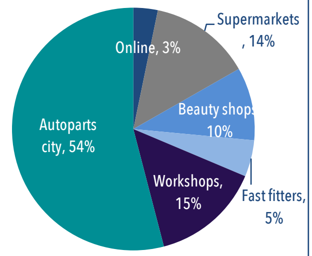
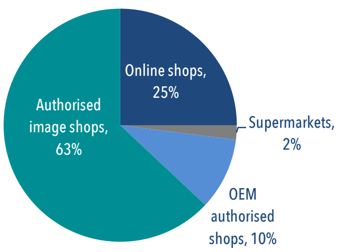
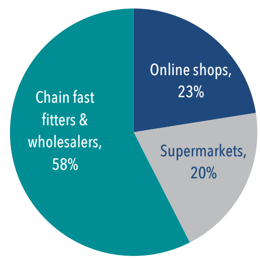


Figure 8 - Price ranges of competitors for wheel & tyre and wax & polish product groups

Figure 9 shows the distribution of the competitors' sales across their respective channels in 2011 with growth rates compared to the previous year. It is apparent that not all competitors sell to the same channels, this is in part influenced by the fact that each competing firm defines their channels differently. Judging from the three players with the largest market share (competitors A-C) e-commerce, with its high growth rates, appears to be the channel offering the greatest future potential.

	Competitor A	Competitor B	Competitor C
Channel sales split 2011	**Total: CNY 112.3 million** 	**Total: CNY 92.4 million** 	**Total: CNY 31 million** 
Channel growth rate (2010-2011)	Online shops: 50%	Online shops: 40%	Online shops: 15%
	Supermarkets: 2%	Supermarkets: 40%	Supermarkets: 10%
	Beauty shops + accessory shops + wholesalers: 17%	Beauty shops: 30%	Beauty shops:15%
	OEM authorised shops: 70%	Accessory shops + wholesalers: 20%	Fast fitters: 10%
	Workshops + fast fitters: 5%	OEM authorised shops + workshops + fast fitters: 20%	Workshops: 15%
	Gas stations: 3%		Accessory shops + wholesalers: 20%

	Competitor D	Competitor E
Channel sales split (2011)	**Total: CNY 16 million** 	**Total: CNY 8 million** 
Channel growth rate (2010-11)	Online shops: 10%	Online shops: 10%
	Supermarkets: 10%	Supermarkets: 5%
	OEM authorised shops: 20%	Chain fast fitters + wholesalers: 10%
	Authorised shops:30%	

Note: Each competitor has its own definition of "channel". Channel share is based on each competitor's sales revenue, not market product value.

Figure 9 - Competitor sales split and channel growth rates

2 Distribution evaluation

2.1 Types of distributors and distributor management

Ipsos Business Consulting's research of distributing firms within this market mostly focused on general distributors used by foreign competitors. Sub-tier distributors are always used by general distributors but their exact types, business models, management factors and frequency were not covered by the scope of the research. City-level distributors, which form the lowest tier of distributors, are too numerous to enable accurate analysis and therefore remain beyond the scope of this report.

General distributors are large nationwide distributing firms operating with logistics and warehouse capabilities. As stockholding resellers they receive imported goods from suppliers, stock them and distribute them. Some general distributors operate exclusively within a specific industry segment selling only one brand or the brands of one manufacturing company, most carry multiple brands and distribute a variety of brands with different product lines to different industrial segments. As nationwide operators these distributors always use some regional system which typically divides China into six-to-eight territories. They sell directly to supermarkets and other wholesalers as well as usually setting up a flagship ecommerce store on Tmall.com. General distributors work through a network of sub-tier dealers to distribute to the remaining channels.

Management of sub-tier distributors is quite diverse. A common practice imposes annual sales targets on them to ensure minimum sales through each tier-1 or city dealer. These dealers typically receive bonuses of 1-2% for meeting their targets. Additional financial support is provided to sub-tier dealers in a variety of ways including rebates for quick payment processing or supplying them with free products for orders over a certain quantity. Sales and marketing programs include attending exhibitions to promote the client's brand and develop sales leads as well as sending out free sample products to attract new clients. Manufacturers provide general distributors with posters and other advertising collaterals some of which are passed on to sub-tier dealers. Some manufacturers also have branded product display requirements that distributors must follow in order to ensure uniform product display across all end channel points of sale. General distributors also provide technical and sales training seminars and allocate salesmen to their sub-dealers to offer support and gain feedback.

The two types of sub-tier dealers differ mainly in terms of their geographical reach. The first type are tier-1 dealers who operate on a provincial level, meaning they cover one to a few provinces. They are the "go-to" choice for most general distributors and are easily available in most regions (slightly less in lower tier regions, eg Northwest China). There is not enough information to cluster them by size or business model but the typical distributor in this market is a simple reseller who stocks the products and goods of its clients. These tier-1 dealers normally obtain products from general distributors or in some cases from the manufacturer's branch offices. Their purchase price ranges from 30-60% of the market retail price. Tier-1 dealers have to meet sales targets set by general distributors or the manufacturer's branch offices and are often assigned a territory to sell into. It is unusual in this market for tier-1 dealers to be offered territorial or brand exclusivity. Tier-1 distributors target available end channels, with the exception of supermarkets, which they either access directly themselves or through a layer of city-level dealers. Additionally, it is common for tier-1 dealers to run their own online shops where they offer their whole product portfolio which includes the manufacturer's products. This unofficial distribution of branded products limits the manufacturers' sales through their official e-commerce channels. Tier-1 dealers' capabilities and competencies to sell to specific end channels were not part of the analysis and are therefore unknown.

City dealers are the second type of sub-tier dealers in this market. City dealers are less focused than their larger counterparts and try to sell a large variety of products to cities within their footprint. This category typically includes stockholding resellers and those without stock as well as agents working on behalf of upper-tier distributors. They pay more for products from suppliers than tier-1 distributors. Common management practices of city dealers cannot be clustered as they are to great in number and therefore evade analysis in this case. Figure 10 provides an overview over the different types of distributors.

Distributor Type	Frequency	Distributor Features	Management Characteristics	Target channels
General distributor	▪ Limited availability due to size	▪ Stockholding reseller ▪ Operates nationwide ▪ Works with region-based system (6-8 regions) ▪ Both single brand (exclusive distributor not selling competing products) and multi brand (selling competing products of one segment)	▪ Provides technical and sales training seminars ▪ Dispatches salesmen for support/feedback ▪ Offers rebates (1-2% of annual sales revenue) ▪ Supplies free goods for orders over certain quantity ▪ Attends exhibitions, promotes client brand and develops clients ▪ Sends out free samples to create sales leads ▪ Provides advertising materials (product posters, etc.) ▪ Cooperates in product display design to have uniform brand design	▪ Manages flagship store at Tmall.com ▪ Sells directly to supermarkets ▪ Uses sub-tier dealers to reach other channels
Tier-1 dealer (provincial level)	▪ The "go-to" choice ▪ Largely available, slightly fewer in lower tiers	▪ Normally stock-holding resellers ▪ Average size, business model unknown	▪ Sales targets set by suppliers ▪ 1-2% bonus for meeting sales targets ▪ Obtains products at 30-60% of market retail price ▪ Assigned territory, either 1 or few provinces	▪ All end channels except supermarkets, might use city dealers ▪ Runs own unofficial online shops ▪ Ability to sell to specific end channels unknown
City dealer	▪ Largely available in all regional tiers	▪ Resellers with or without stock, possibly agents ▪ Average size, business model unknown	▪ Similar to tier-1 dealers ▪ Obtains products at higher percentage of market retail price	▪ All end channels except supermarkets and online shops

Figure 10 – Distributor overview

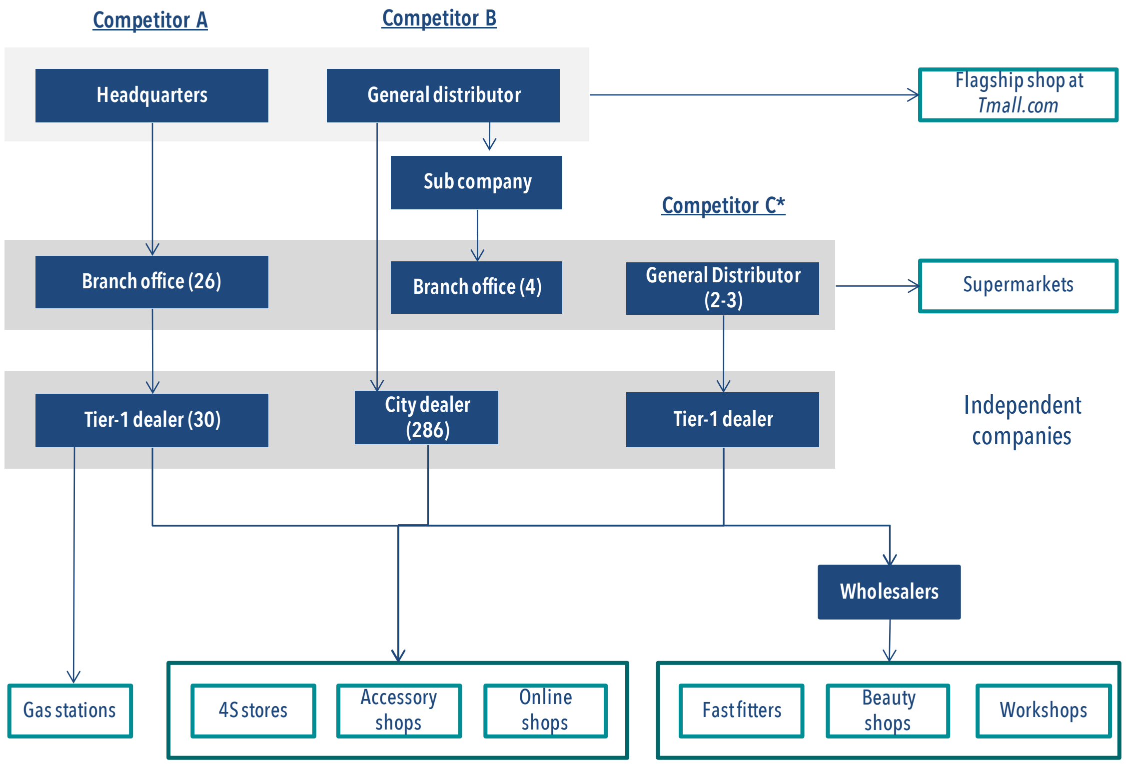
2.2 Key competitors' distribution strategies

Looking at the distribution channels of competitors A, B and C highlights different models for the client, each of which has its own pros and cons which are listed in section 4.1. Figure 11 illustrates the various distribution channels.

Competitor A is the only foreign manufacturer with on the ground operations in China, where it has a headquarters and 26 branch offices. This competitor is active in numerous industries besides the car maintenance and beauty market and has established nationwide offices to manage those operations. Each branch office manages up to a few tier-1 dealers of which there are about 30 nationwide. The headquarters is in charge of A's flagship store on Tmall.com and the branch offices directly sell to supermarkets in their region. Tier-1 dealers are in charge of the remaining channels. As competitor A also sells fuel and oil additives, gas stations are one of their end channels, too.

Competitor B distributes its products through a single general distributor. This exclusive distributor essentially acts as the local headquarters for competitor B as it directs the flagship store on Tmall.com. It is the single channel through which Competitor B's products flow into the Chinese market. The general distributor uses two additional channels to further its reach: a sub-agent with four branch offices which it uses to access supermarkets around China, and another 286 city-level dealers which it directly manages to sell into the remaining channels.

Competitor C also has no direct operations in China and uses two or three general distributors. By using multiple general distributors the competitor has better chances of achieving sales than a company that only uses a single distributor. These general distributors have no flagship store to run and focus on selling direct to supermarkets. They also use an unknown number of tier-1 dealers to distribute their client's products to other end channels.



Note: The structure of Competitor C's main distributor

Figure 11 - Competitor distribution structures

3 Company evaluation

3.1 Business scope, business strategy and product positioning

The client's business scope depends on the final production of its car care, appearance and performance products. All their product lines are very closely related and specifically target the automotive maintenance and beauty markets. The scope of the client's business does not cover upstream parts of the value chain that deal with raw materials which are dealt with by partner companies. While the client distributes its products to every continent, this study solely focuses on the scope on China's emerging market.

The client company's business strategy focuses on delivering mid-level margins and volumes. They manufacture brand products that target customers who want to use quality brand auto care and beauty products rather than seeking low budget or exclusive high-end alternatives. The Chinese automotive maintenance and beauty market comprises numerous local brands which cater to the low- or middle-end price segments. Foreign brands mostly compete within the medium and high-end product segments with only one foreign brand (Competitor D) setting itself apart by targeting high-end/luxury consumers. The client company competes with other foreign brands in the mid-to-high price segment as well as offering slightly cheaper solutions.

The client company does not need to use extremely short distribution channels to benefit from high margins as its strategy targets neither the low-end or luxury segments. However, it also cannot afford to have too many layers within its supply chain.

The analysis covered 11 different product groups within the maintenance and beauty segment which were divided into three main segments: cleaning products, beautifying products and maintenance products. Cleaning products include washes, cleaners and degreasers, wipes and accessories. The key beautifying products are waxes and polishes, wheels and tyres, protectants and air fresheners. The maintenance product group comprises fuel additives, functional fluids and oil additives.

3.2 Resources

The client company is severely limited by the limited availability of its human resources. Event though it recently opened a branch office in Shanghai it has few staff with experience of working in China. Its reluctance to hire new employees means it only has two staff dedicated to organising and managing distribution.

Their presence in the Chinese market depends on a single non-exclusive distributor which not only carries competing brands within the car appearance and care segment, but also operates in the industrial and home cleaning product sectors.

Ipsos Business Consulting did not have detailed knowledge of the client's financial position, but it can be assumed that they are restricted in spending or are at least very hesitant to do so. The amount of capital available for investments in the distribution structure was limited.

3.3 Objectives

While the client's internal objectives remain for the most part confidential, Ipsos Business Consulting was hired to analyse the market and develop a market-entry strategy while the client would draw up a marketing plan. Such a marketing plan would set sales volume targets for both the overall Chinese market and individual distributors, develop a comprehensive branding and communication strategy and establish concrete goals for product coverage and availability.

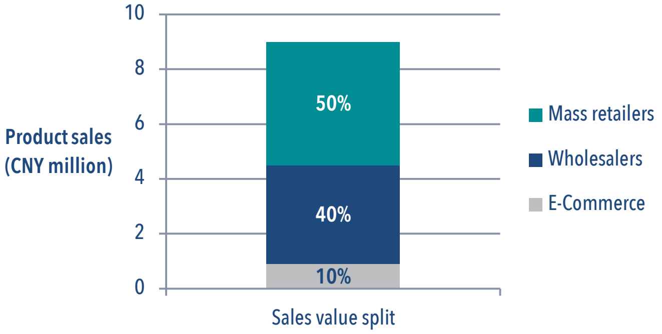
3.4 Existing distribution structure and distributor management

The client company has very limited distribution channels with the recently established branch office in Shanghai being the first location it directly controls. They rely on a single general distributor to distribute their products to a limited number of channels.

The exclusive distributor is a Chinese firm dealing with both industrial and consumer goods. They carry competing automotive appearance and care segment brands alongside the client’s products. Their product portfolio also includes industrial products and home cleaning products. The general distributor has three sub brands or subsidiaries located in Beijing, Shanghai and Guangdong and an additional 18 provincial dealers that cover 420 major cities within China.

The client’s general distributor indirectly covers commonly used channels within the maintenance and beauty segment as shown in figures 12 and 13. They almost exclusively focus on mass retailers (Walmart, Metro etc) and wholesalers sell on to end channels. Figure 12 provides an overview of the client’s sales distribution. A tenth of the client’s sales value is being generated through online shops like 360buy.com or taobao.com. Common channels such as gas stations, 4S-stores, workshops, fast fitters, beauty shops and accessory shops are not currently directly targeted as potential sales points for the client’s products.

The client’s distribution channel setup and sales value split, as shown in figures 12 and 13, highlight additional challenges due to the lack of information made available to the client about where its products end up and what route they take to end consumers. The distributor sells the majority of the client's products through its network of retailers and wholesalers but additional channels remain unknown. This essentially means that the client does not know who its end customers are. It has not implemented a distributor management system. Neither does it impose sales targets or territorial restrictions and it previously provided little support as the Chinese market was not a primary focus. Furthermore, the general distributor essentially acts as an exclusive distributor as the client currently does not use other distributors.



Note: Not all product groups of client’s product portfolio included as some products are not yet being sold

Figure 12 - Client's sales value split by channel

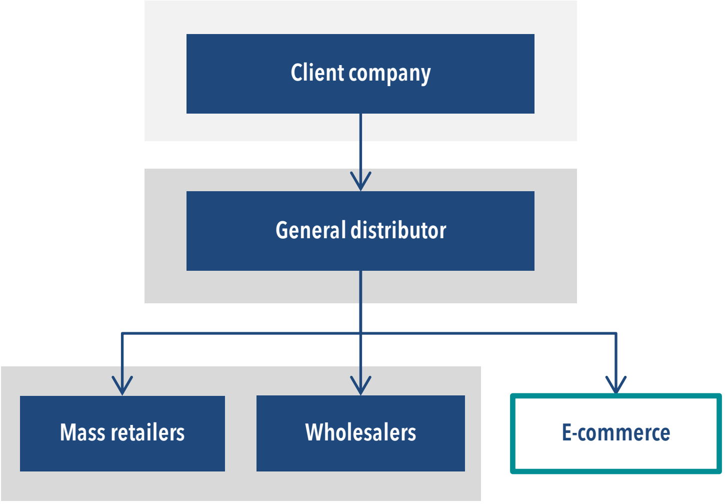


Figure 13 - Client's channel structure

4 Key insights and suggested distribution model

4.1 Key insights

Market analysis reveals a moderately low number of layers between manufacturers and end consumers within the Chinese automotive beauty and maintenance market. End channels are of varying importance with indirect channels such as 4S-stores, beauty shops and large workshops being high priorities due to their significant contributions to total sales value. Other indirect channels, such as fast fitters and small workshops, remain secondary priorities with gas stations being of particular interest for fuel additives while supermarkets are selling increasingly more DIY products to the market. The online channel is also expanding rapidly.

Analysing distribution reveals three different types of distributors. General distributors operate nationwide, or at least cover a large part of China, and are often used as the exclusive distributor/representative for foreign manufacturers in the country. Tier-1 dealers operate in up to a few provinces while city dealers cover a city and its surrounding area. The latter two are used as intermediate distribution partners who sell to their respective regions.

The distribution structures of the client's direct competitors include having a local headquarters in charge of tier-1 dealers and using one to a few general distributors to use their distribution network to sell to the market. Management methods are partly known for general distributors but are unknown at the sub-tier dealer level.

The client positions itself in the mid-to-high price segment. Although it has established itself in the market, the client's distribution structure is very underdeveloped. The only general distributor it uses only covers a fraction of available end channels. The client lacks knowledge about its market penetration and who its end consumers are.

	Key insights
Market analysis	▪ Moderately short channel length, low number of layers ▪ End channels: – High priority: 4S-stores, beauty shops, large workshops and gas stations (only crucial for fuel additive business) – Medium priority: Fast fitters, supermarkets are becoming increasingly important, e-commerce rapidly expanding – Low priority: Small workshops ▪ Current market potential in coastal provinces of east China ▪ Future market growth in mid-western regions
Distribution analysis	▪ 3 types of distributors with different geographical reach – General distributor (nationwide) – Tier-1 dealer (provincial) – City dealer (city level) ▪ Direct competitors use – Direct operations through headquarters, offices – Indirect operations through general distributor ▪ Management factors largely unknown for tier-1 and city dealers
Client analysis	▪ Product portfolio positioned in middle-high price segment ▪ Little information about client internals (objectives) ▪ Unaware of who end consumer is, what channels are served ▪ Indirectly operating through single general distributor ▪ Limited in resources (staff, finances)

Table 3 - Key analytical insights

The client can choose from a wide range of distribution mechanisms as demonstrated by the different models implemented by its competitors. However, each options carries specific advantages and disadvantages.

The most pressing decision for the client is whether to stay with its current general distributor or terminate the agreement and partner up with one or more other general distributors. The current general distributor has a large portfolio of products, which includes those of the client. The general distributor's historical sales performance is poor when reviewed in light of the growing market and success rate of competitors. There are many potential reasons for these lacklustre results including poor motivation and use of direct resources by the general distributor to drive sales as well as weak product knowledge and a lack of distribution partners.

This is a very common issue for companies that try to passively develop their market and fail to implement strong distributor management systems. The issue revolves around the following common conundrum:

- Trying to find new distributors carries the risk of losing the sole distributor which would have a catastrophic impact on earnings. Locating, evaluating and setting up new distributors is a lengthy and costly process.
- Assessing the potential of the current distributor also requires a lot of time to align objectives, sales targets , which limits the ability of the manufacturer to find new distributors.
- Doing both requires even more time and investment.

A further decision weighs the pros and cons of using general distributors to handle distribution mostly on their own against establishing a more physical presence by setting up operating branches in China. Having one's own branches affords direct control over distributors further down the supply chain (tier-1 and city dealers) and reduces channel length by cutting out general distributors. However, this option requires significant investment in staff and facilities. The choice between using one or multiple general distributors is really one of effort. Each additional distributor increases management commitments and expenditure but also reduces the risk that comes with depending on a single distributor if that distributor fails to perform.

While major local distributors provide an established distribution network they often carry multiple other brands, including competing brands that target the same market leading to a conflict of interest where the distributor follows the greatest incentives and focuses on products with the largest profit margins.

Table 4 and figure 14 illustrate the options below.

Own presence (branches)	Multiple general distributors	Single general distributor
+ Direct control over sub-tier distributors + One less layer, greater control of market price, higher margins possible	+ Provision of established distribution network + Lower level of dependency	+ Cheapest option + Lowest management effort required + Provision of established distribution network
– Requires highest level of investment – Own warehousing required	– Conflict of interest if carrying competing brands	– High level of dependency – Conflict of interest if carrying competing brands

Table 4 - Client distribution options

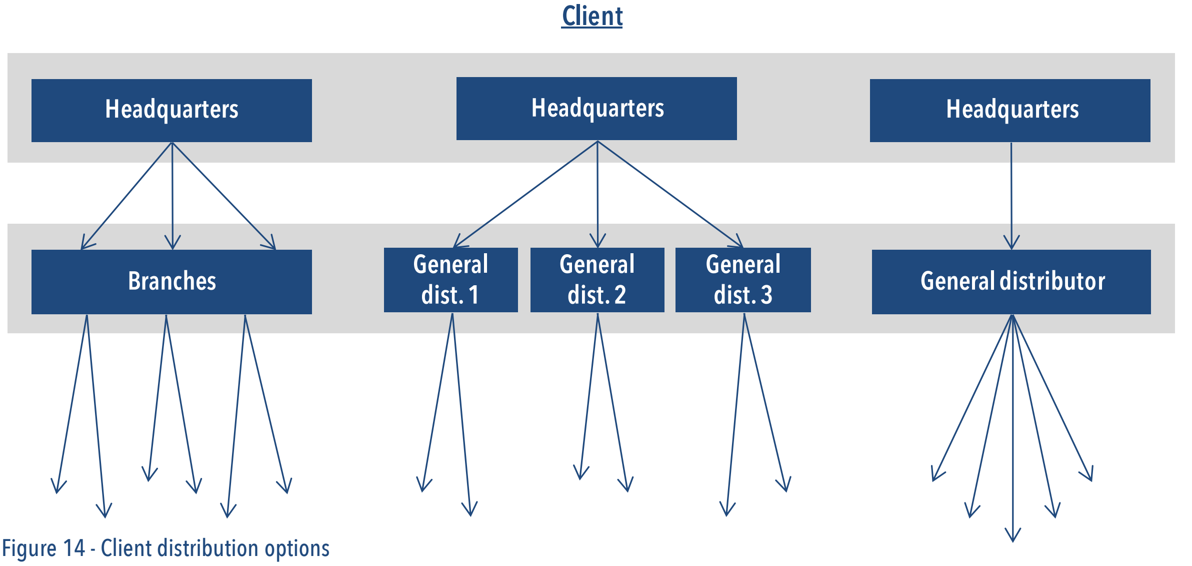


Figure 14 - Client distribution options

The third decision regards downstream distribution channels and whether the client should use tier-1 dealers or attempt to directly manage city dealers through its own branches or its general distributor. It is common practice in China to have several tier-1 distributors in charge of different regions. They are responsible for further distribution and are themselves likely to approach city-level dealers. The other option of directly managing city level distributors brings the benefit of being closer to end consumers and increasing margins by reducing the length of the supply chain. The large additional management effort which translates into higher expenditure is the main reason why this model is rarely used in the local market.

Use of tier-1 dealers	Directly managing city dealers
+ Common distribution method + Access to an established distribution network (further distribution taken care of by tier-1 dealers)	+ One less layer, greater control of market price, better margins possible
– Additional layer, lower margins	– Significant management capacity required

Table 5 - Client distribution options (2)

Options for management of dealers are numerous and depend largely on the chosen distribution channels. They will be addressed in the concrete model recommendations (see sections 4.2 and 4.3).

4.2 Optimal distribution strategy

To fully outline an optimal distribution channel model, more detail is needed about the client's goals and tier-1 distributors in the market – ie exact sales target and coverage goals on the client side as well as characteristics, common management factors and target channels of distribution firms on a provincial level.

Existing information, however, makes it possible to recommend a clear business model for the client. An ideal model would of course require the client to have a direct presence in China which would help it increase its proximity to end consumers and facilitate quicker decision making and responsiveness to changes in the market. The client's office in Shanghai is a start but would need to expand its size and operational capacity to function as a China headquarters.

This headquarters in Shanghai, which also doubles as the local branch office, directly manages 20 to 30 tier-1 dealers across the country and covers most provinces, a key goal of the client. The cost and effort required to directly manage city-level dealers would way outstretch the client's resources making the proposition untenable. As most tier-1 distributors do not work on an exclusive basis where they only sell a single supplier's brands, a set of management incentives would need to be put in place to ensure no distributor neglects or rejects the client's product. This would include offering attractive margins, reasonable sales targets and regional exclusivity. Furthermore, the use of support programs is essential. Dealers at this level typically lack the technical and marketing knowledge needed to effectively promote products and commonly receive support from clients to help overcome this skills gap. Such support includes financial incentives (rebates and bonuses of 1-2%, extra goods for large orders), marketing (advertising and marketing collaterals) and sales support (sales lead generation through free samples and presence at industry exhibitions as well as support from the client's sales team in terms of sales and technical aspects). On rare occasions where a tier-1 dealer works exclusively for a client, support measures should be increased as additional investments are bound to deliver increased sales. Support in this situation would likely take the form of cooperative measures to increase sales lead generation in the distributor's region.

The client should manage its flagship store on Tmall.com and directly deal with supermarkets across the nation. Tier-1 distributors might directly approach further end channels but they are more likely to use city-level dealers within their territory. The client should forbid tier-1 dealers from distributing their products through online channels and levy heavy sanctions for any breaches to ensure the only authorised e-commerce channel is Tmall.com.

Control measures and sanctions that ensure tier-1 dealers do not violate territorial restrictions should be an important part of distributor management. Competition between tier-1 dealers through cross-selling might lead to cannibalization and lower margins across the board. The client would need to consistently monitor its distributors and threaten to impose sanctions. Figure 15 shows the structural layers of the proposed distribution strategy.

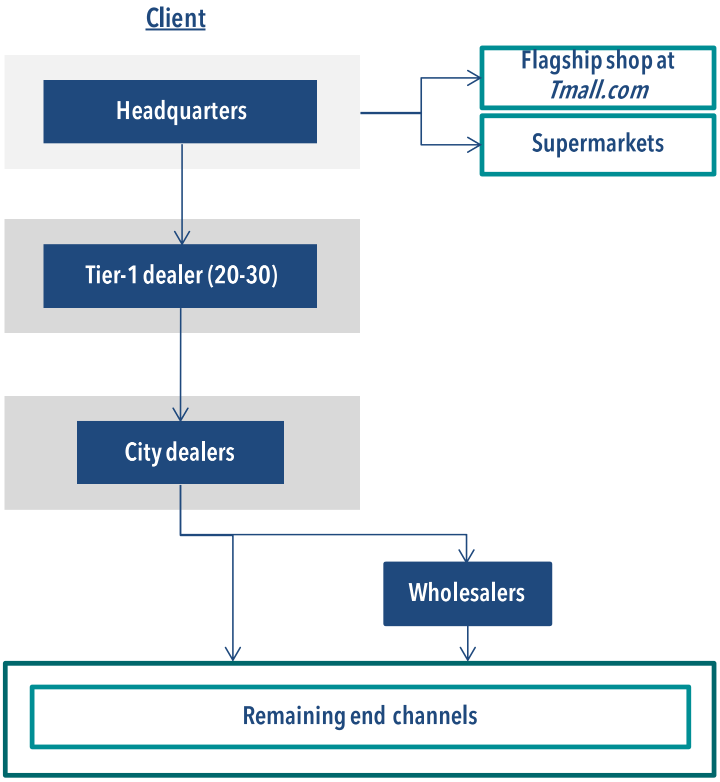


Figure 15 - Recommended optimal distribution structure for the client

This model represents an optimal distribution model for current market conditions. It provides an effective approach for taking into account both optimal sales coverage and distributor management requirements and offers a way to effectively sell into all regions.

Further analysis of the marketplace in a couple of years time would be necessary to determine if changes in the market would necessitate a different distribution channel strategy. For example, if general distributors show they can successfully handle the products they carry and sell them in their regions without requiring significant sales and marketing support from the supplier, it might not be necessary for manufacturers to directly manage sub-tier dealers in order to efficiently deliver sales and profit.

Since the client is a relatively new player in this market, its current distribution structure falls far short of this optimal strategy and it needs to place more emphasis on a short-term strategy which focuses on achievable goals and outlines key first steps.

4.3 "First steps": a short-term distribution strategy

It is not currently possible for the client to come close to the optimal distribution strategy as the company uses a single general distributor which carries competing products and has little motivation to sell the client's products. Furthermore, the client lacks sufficient resources and only has a minimal staff and limited funds. As such Ipsos Business Consulting recommends an optimal short-term approach that focuses on key markets and retains most parts of the client's existing distribution structure. This is a practical trade-off between what the market and distribution landscape offers and what the client can actually achieve with its available resources. It involves the client' managing tier-1 dealers in attractive high sales-volume markets through its office in Shanghai. The general distributor would ensure the client's products are distributed to all other markets.

Ipsos Business Consulting's market research shows the majority of passenger vehicles are located in seven provinces or municipalities – Guangdong, Jiangsu, Beijing, Shandong, Hebei, Zhejiang and Shanghai. A further social listening study found that more than half of the content posted on the internet about the client's product portfolio originated from within these seven regions. The client should therefore consider directly dealing with these regions and cut out its general distributor if it continues failing to deliver acceptable sales results. In regions where the general distributor is strong the client can consider leaving him in charge. Since these seven regions can be grouped into three geographical areas (region 1: Shanghai, Jiangsu, Zhejiang, region 2: Beijing, Hebei, Shandong and region 3: Guangdong) the client should directly manage the area where it is already located, region 1, through some tier-1 dealers and develop experience in identifying, managing and evaluating dealers. For regions 2 and 3, it should either continue using the current general distributor or approach new general distributors who can cover those areas. The client company's resources are too limited to effectively directly run operations in regions 2 and 3.

The client's headquarters should establish and manage the branded flagship store on Tmall.com and take over the important supermarkets channel nationwide from its current general distributor. The distribution of the client's products through online shops by general distributors and sub-tier dealers should be strictly forbidden and sanctioned so that the flagship Tmall.com portal is the only authorised e-commerce channel. Remaining end channels would be addressed through the network of tier-1 dealers.

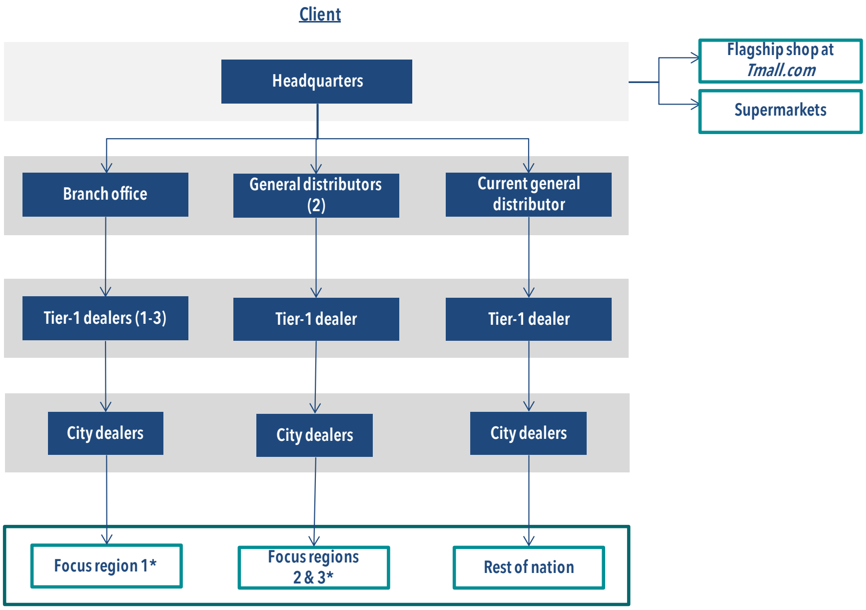
The same methods outlined in section 4.2 should be used to manage these tier-1 dealers. The main goal is to provide them with large incentives to sell the client's products, such as attractive margins, reasonable sales targets and regional exclusivity. This, again, requires the client to monitor distribution of its products and impose sanctions for cross-selling.

Although the general distributor will become less important, the client should increase its management efforts in this regard. Margin seems to be the most important factor. Financial support measures might result in higher sales by the general distributor. Offering additional support, such as sales and marketing, is not advised as the distributor seems primarily focused on profit margins and not the fact that it may lack the technical expertise to improve sales. Granting the distributor territorial exclusivity would definitely be a mistake since a key recommendation is the eventual termination of business relations.

These steps should ensure higher profits in key markets where the present general distributor is failing to deliver sufficient sales as well as helping the client identify its end consumers. Continued cooperation with the general distributor in most of the remaining parts of China would ensure the client's products remain available nationwide.

This approach enables the client to gain greater experience in the Chinese car maintenance and beauty products market and about how to better manage distributors and their management. At a later date, the client might consider expanding the number of general distributors it works with while winding down its relationship with the current general distributor. These other general distributors might be exclusive dealers which do not carry competing products. Or they might specialise in selling to targeted segments, such as 4S-stores which currently represent one of the most attractive channels.

Figure 16 shows this short-term distribution structure.



* Note: Regional focus based on number of existing passenger vehicles in China:
Region 1: Shanghai, Jiangsu, Zhejiang, region 2: Beijing, Hebei, Shandong and region 3: Guangdong

Figure 16 - Optimal short-term distribution structure for client

Appendix – Regions of the People's Republic of China

There are a number of ways to divide up the Chinese mainland. One of the most common uses six regions:[2]

- North China
- Northeast China
- Northwest China
- Southwest China
- South-central China
- East China

These terms have been used in this paper to refer to the different regions of the People's Republic of China.

Figure 17 - Regions of the People's Republic of China

[2]As used by the National Bureau of Statistics of China

Provinces of the People's Republic of China

- Provinces:
  - Hebei
  - Shanxi
  - Liaoning
  - Jilin
  - Heilongjiang
  - Jiangsu
  - Zhejiang
  - Anhui
  - Fujian
  - Jiangxi
  - Shandong
  - Henan
  - Hubei
  - Hunan
  - Guangdong
  - Hainan
  - Sichuan
  - Guizhou
  - Yunnan
  - Shaanxi
  - Gansu
  - Qinghai
  - Taiwan
- Municipalities:
  - Beijing
  - Shanghai
  - Tianjin
  - Chongqing
- Autonomous regions:
  - Inner Mongolia
  - Guangxi Zhuang
  - Tibet
  - Ningxia Hui
  - Xinjiang Uyghur
- Special administrative regions:
  - Hong Kong
  - Macau

Figure 18 - Provinces of the People's Republic of China, reprinted from Wikipedia[3]

[3]http://en.wikipedia.org/wiki/Provinces_of_the_People's_Republic_of_China

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