Analysis of distribution networks of fmcg industry marketing essay

INTRODUCTION:

Distribution process consists of all the activities undertaken by manufacturer, either alone or in sync with other channel members in order to make the product available to consumers.

Distribution can mainly be divided into two major components:

Distribution network comprising of distribution channels

Logistics or physical distribution

Efficient distribution and logistics are prerequisites for smooth transit of goods. Selling is the end process of distribution as this leads to change in ownership of product. Distribution is the most vital element for the success of FMCG companies. Efficient distribution network ensures brand is delivered in right quantity, right place and right time in good condition and at competitive rates.

Objective of distribution network of FMCG companies:

Availability of Brand: Distribution network ensures that the product is on the shelf or in outlet when consumers want to buy.

Quality of product: Companies ensure that not only the product is available at right time but also in right condition and quality like freshness, package etc.

Optimum price: Effective distribution also ensures that the cost of product is competitive when it reaches final consumer.

Types of distribution channels:

Direct Distribution: In this case: Companies have direct control over the goods distribution either to retailers or exclusive distributors.

Fig 1: Direct Distribution

Advantages of direct distribution:

A simplistic and direct distribution line

Efficient communication between the distributors and suppliers.

Indirect Distribution: This type of distribution occurs when intermediaries are involved in the distribution process.

Types of Channel Members

A typical distribution channel consists of the following members:

Agents/Brokers: These are channel partners that match demands of manufacturer with wholesalers or in organized market with customers. They are very important for exports and international marketing.

Wholesalers: These are someone who primarily sells to other retailers. They typically buy in bulk and are very important in rural India.

Retailer: Retailers are most visible face of the distribution system. India has the largest number of retailers in the world.

Factors affecting Distribution network

Type of product:

Type of customers

Market considerations

Internal considerations

Legal considerations

Challenges and solutions in FMCG Distribution Networks

Value Chain De-verticalization to handle the huge distribution network requirements

India has approximately 6 million retail outlets with around 2 million in over 5000 towns and 4 million in 600, 000+ villages. Although super markets have made in-roads into India, their presence is limited to modernized urban areas. This poses a huge challenge for logistics and distribution, especially for new players.

A solution to this problem is Value Chain De-verticalization which involves achieving organizational separation through outsourcing the supply chain activity to a 3rd party. This will often involve selling existing Operation assets and activities to a financial buyer, 3rd party manufacturer/distributor or a joint venture with other FMCG companies. This essentially makes the company in question “ asset light” while the supply company becomes “ asset heavy”.

How De-verticalization unfolds to reduce barriers of entry

This allows the management of the FMCG Company to focus solely on customer and consumer management which is its main growth driver. On the other hand, the 3rd party providers can build their assets and networks in a

robust way which they will lend out to the FMCG companies which outsource the supply chain activities to them. Managing supply chain activities being their core activity, they are able to put 100% focus on this and hence achieve efficiency and responsiveness which will help all its clients.

To cite examples, a few FMCG companies like Sara Lee and Nike have already treaded this path and have been quite successful. However, there is a lot of scope for a huge chunk of FMCG companies to follow this.

Intermediary reduction for reducing supply chain costs

With time, organized retail chains are setting up systems for inventory management and quick servicing. This is in turn providing opportunity for the companies or suppliers to reduce distribution cost by reducing intermediaries like wholesalers and distributors. The FMCG companies can use this to their advantage and supply directly to the warehouse of the retailers thereby reducing costs immensely. A part of this benefit can be passed over to the customer making the companies more competitive while the other part can be shared between the company and the retailer. Thus this helps in increasing the efficiency of an FMCG company.

Driving channel width for increasing sales

The share of FMCG sales done through grocers had decreased from 50% in the early 90’s to around 35% in the late 90’s. This is due to the increase in contribution from other outlets like chemist outlets and paan shops. FMCG companies need to promote this increase in channel width by redesigning their SKUs (e, g, sachets) and hardware (e. g. mini dispensers). This in turn

will give them benefit through increased sales by higher accessibility of their products thus increasing the responsiveness of the distribution network.

Increasing visibility of secondary sales through web connectivity with redistributors

A typical distribution network will consist of goods passing to Clearing & Forwarding Agent (CFA), then to Redistributors (RD) and finally to Retailers. While it is convenient to connect with and track sales of the CFAs which are less in number (typically one or two in every state), it is immensely difficult to track the sales that is happening from the RDs. This is due to the huge number of RDs present in a distribution network.

To enable this, FMCG companies can use the web to connect with the RDs and major retailers to obtain their sales data. This will help them in achieving better visibility and hence better forecasting of sales at different points of the distribution network. This leads to a substantial increase in efficiency for the company.

Differentiating by using the internet as a distribution channel

The future of most products probably lies in using the internet as a point of sale and reaching out to the customers directly. FMCG companies will be no exception to this and will soon have to join the bandwagon which will give them a massive boost of responsiveness to consumer demand.

We will now examine the distribution networks of three largest FMCG players in India: HUL, Marico and ITC. We will further see the issues they face in their

distribution network and how they have/can solve them to gain better customer service levels.

ANALYSIS OF HUL'S DISTRIBUTION NETWORK

Introduction:

HUL is India's largest FMCG with 20 different brands in different categories. The turnover in terms of volume for HUL was about 4 million tonnes whereas in monetary terms it was nearly 17523 crores.[1]According to HUL website every 2 out of 3 households in India use some HUL product.

HUL has products in 6 different categories with its brands being the top selling ones in most of the categories. Some of the famous brands of HUL are given below:

Food Products: BrookeBond, Bru, Annapurna, Kissan, Knorr, Kwality Wall's

Home Care Products: Wheel, Domex, Rin, Surf Excel,

Personal Care Products: Axe, Clinic plus, Dove

With such a large product portfolio and sales turnover, the distribution network of HUL has been successful to reach out to almost all the regions of the country. The distribution network is what gives HUL its competitive edge over its competitors like P&G, ITC and RB.

We will first examine how the distribution network of HUL was modified in different stages and then the present network.

Stages of Evolution:

The first stage involved the wholesalers and big retailers giving bulk orders to the HUL sales person. The sales person would collect al the orders from his area and put a consolidated order to the HUL office. All the orders were transported together to the salesperson who then redistributed it to the buyers. This network put major emphasis on bulk ordering and full truck load transportation. As all the orders in one area were transported together, the cost of transportation from factory to sales person was less. But the redistribution cost was high and also the administrative costs with more no. of sales person to cover maximum regions possible made it an expensive network.

In the second stage, the concept of registered wholesaler (RW) was introduced who would stock all the products for the company. The salesperson collected orders from the market and redistributed the products from the stock at RW. Having a common stocking point allowed the salesperson to cover more regions and hence increased the reach of the distribution network. Apart from reducing the transportation costs, this method also increased the customer service levels.

Present Day Distribution Network:

The present distribution network has the RWs replaced by redistribution stockists (RS) who provided the distribution units to the salesperson. There were also Company depots which acted as stocking point s and bulk breaking venues. The company depots have now been replaced by Carrying & Forwarding Agents (C&Fas). They transport the products to the Rs and also act as buffer stock points to ensure minimum stock outs.

The role of RS is important in this network as it services retailers, provides warehousing facilities, implements all promotional activities, reports the market data to the company etc. The product flow in the Distribution network of HUL is as shown below:

Fig 1: Traditional Retail Distribution Network of HUL

In the present day network, HUL has 4000 redistribution stockists, covering about 6 million retail outlets. There are 35 C&FAs who work to supply to the RS across the countries. The distribution network reaches to almost all the urban population and about 250 million rural customers by servicing the grocery stores, medicine stores, kiosks, general stores. To service the upcoming super value stores and the self service stores in the urban areas, HUL has tailor made its channel design to suit their requirements.

HUL has 40 manufacturing plants which are serviced by 2000 suppliers across the country. We will examine the distribution network of HUL separately for the Urban and Rural India as the strategies involved and the channel design are different for both the areas.

Distribution Network in Urban Areas:

In the urban areas, HUL follows two channel selling types:

Traditional Retail Channel

Direct Selling through Hindustan Lever Network (HLN)

The distribution of goods from the manufacturing plants to the C&F agents takes place through rail/road depending on the optimum cost factor. The

manufacturing plants have been strategically located to cover the almost all the geographical area of India. From the C&F agents the products are transported to the RS through truckloads and then to the retailers by using the local transport modes.

In the direct selling through HLN which is the Direct Selling Channel about a lakh independent entrepreneurs spread over 1500 cities and towns. This channel services the Home & Personal care category of products and is backed by about 240 service centres. HUL is trying to leverage on this concept by making the channel more participative through Revenue Sharing rewards etc.

Rural Distribution Network:

The rural areas have a large untapped market and the lack of transport infrastructure and distribution factors made it difficult for the FMCG players to fulfil the demands. HUL, through its innovative concepts of Project Shakti and Project Streamline has now reached 50000 villages and around 250 million customers. The reach of the distribution network in rural areas is one of biggest strengths of HUL.

In the rural channel design, a RS is made responsible to service all the villages of a particular town. For some accessible markets, HUL had a sub stockist appointed who was responsible to transport the goods to all the village retail outlets by means of available transport like cycles, bikes etc. This has helped HUL reach even the most remote villages with no connecting motor able roads.

In Project Shakti, groups of villagers use micro credit from banks to buy HUL products from the rural distributor and then sell them directly to the villagers. This has helped HUL reduce its transportation cost to distribute products in remote villages.

Project Streamline was initiated to cater to inaccessible markets with high business potential. A sub-stockist or a Star Seller was appointed for each group of villages. The Star seller bought the goods from the HUL rural distributor and transported the products to all the nearby villages through tractors and bikes.

All these initiatives helped HUL increase its customer service levels and minimise stock outs. Adexa iCollaboration suite was used for facilitating centralized monitoring of SCM, integrating production scheduling and demand & distribution planning. This increased the responsiveness of the supply chain, reduced inventory buffers and optimized the scheduling. With the help of the iSuite the company was able to combine sales and distribution data for different product lines.

Issues in the Distribution Network:

Despite the distribution network being so robust and best in class as compared to the competitors, HUL faces some challenges in the future and has to plan to face them. Given below are some of the challenges and some ways HUL can follow to face them.

Managing modern retails: The traditional retail design has been HUL’s advantage in India. But the advent of Modern retail shops like Walmart, Spencer’s, and Hyper Retail has added another channel design for HUL to

work on. Managing these types of retails has been P&G’s stronghold for years and will have an advantage in this sector.

HUL needs to leverage upon its Hindustan Lever Network to service these big retail chains. These chains prefer to have a customized distribution and replenishment system with their suppliers. (Ex. Wal-Mart with P&G). HUL can use its experience in using IT tools like iSuite and RS Net to cater to these retails.

In a geographically diverse country like India, having the same channel design for all regions is not feasible. For the areas where accessibility is a problem, more layers have to be inserted in the distribution network.

HUL needs to identify the areas where accessibility is difficult and add another layer between the rural distributor and the sub stockists so that the products reach even the remotest parts. With still over a million rural areas to be covered, HUL has a huge scope to improve its distribution network.

With all the FMCG players coming up with the smaller sachets the frequency of purchases has increased and so has probability of stock outs.

HUL uses the concept of Mother Depots which supply to the RS to maintain the stock levels. As the purchase of smaller size packets is more in the tier 2 cities and rural areas, Mother Depots should be located in a town so as to cover these areas.

The distribution costs for HUL (700 crs) is much more than its competitors (P&G: 150 crs and ITC: 550 crs). The transportation costs have a major share in the costs.

The structure of households in India is changing. From a pyramid structure it has changed to a diamond structure with middle level constituting the middle class, the top constituting the affluent class and the bottom the low income class.

The needs and the price sensitivity of each category are different. HUL needs to identify and categorise its products for each of these categories. Having a different channel strategy for each category so that the service levels increase can be looked in to.

Another issue facing HUL if of leveraging the IT tools and using it to generate POS data from the small kirana stores.

The concept of creating Perfect Stores (stores having appropriate product assortment to maximize sales) and mass customizing them as per the purchase trends is in the making at HUL. For this HUL will need Intelligent Information System and a flexible but efficient distribution network that can satisfy the service levels for these Perfect Stores.

ANALYSIS OF ITC'S DISTRIBUTION NETWORK

Introduction

ITC is one of India's foremost private sectors companies with a market capitalization of nearly 100000 crores and a turnover of over 18000 crores. ITC is rated among Asia's ' Fab 50′ and the World's Most Reputable Companies by Forbes magazine, among India's Most Respected Companies by Business World and among India's Most Valuable Companies by Business Today. ITC also ranks among India's top 10 `Most Valuable (Company)

Brands', in a study conducted by Brand Finance and published by the Economic Times. ITC has a diversified presence in Cigarettes, Hotels, Paperboards & Specialty Papers, Packaging, Agri- Business, Packaged Foods & Confectionery, Information Technology, Branded Apparel, Greeting Cards, Safety Matches and other FMCG products. ITC has More than 1000 SKU's with warehousing space of more than 4 million Sqft spread out across 55+ locations . Also Production is carried out across 45+ plants.

ITC's Logistic network overview

Cigarettes:

ITC has a unprecedented market leadership in this segment with a market share of around 70 % . The Dominance of ITC is evenly distributed across all segments and in all geographic locations as wel as price. ITC has an extensive distribution network supprted with state of the art technology as well as products which give it a exciting long term potential in this sector.

Foods

The Foods business is today represented in 4 categories in the market. These are:

Ready To Eat Foods

Staples

Confectionery

Snack Foods

In the ready to eat segment ITC has a market share of 48 % and with a majority of the pie being held by MTR as well.

CONFECTIONERY Confectionary market in India is about Rs. 2500 crore. It is loosely divided into seven categories: 1. Hard boiled candies 2. Toffies 3. Eclairs 4. Chewing gum 5. Bubble gum 6. Mints 7. lozenges ITC has currently in market with its two brands “ Mint-o” and “ Candyman”.

STAPLES ITC entered the staples market in 2002 with wheat flour under the Aashirvaad brand. In 2003, ITC extended the Aashirvaad brand to edible salt. By early 2006, ITC had a 40% market share in the Rs. 6 billion packaged flour business

BISCUITS: Indian biscuit market is estimated to be around 5000 crore. Biscuit industry in India in the organized sector produces around 60% of the total production, the balance 40% being contributed by the unorganized bakeries

In the NON-FOOD segment ITC follows the same model, just that the production centres for the same are: Kolkata, Bangalore, Haridwar and Nainital.

e-CHOUPAL

The e-choupal initiative was designed by ITC to the challenges faced by the Indian agricultural scene characterized by fragmented farms, weak infrastructure and a lot of intermediation by 3rd parties leading to deprivation of the farmers of their dues. The e-choupal benefits the farmers in terms customized knowledge(for land management as well as risk mitigation) Real time information(for commodity prices, weather information

and farm inputs). The company benefits in terms of finding a channel into the untapped rural markets, leasing this channel to 3rd parties(Farm producers) and for direct marketing activities.

e-choupal brought down the chain costs by half and the majority of this benefit was passed on to the farmers in terms of savings in the labour and handling losses. All in all while the farmers benefits through enhanced productivity and gate prices , ITC benefits by having paid lower procurement costs reducing the non value adding activities in the chain, adding features such as insurance and credit facilities for rural masses and using it as a medium for strategic sourcing support for its various divisions.

The Distribution system comprising of village traders, Ghanis, wholesalers, Mandis , cooperatives, traders has been replaced by the e-choupal as the centre of all information.

E choupal serves 4 million people spread over 10 states thorugh 6500 kiosks. It has around 35 hubs at the present and souces its supplies- soyabean, coffee, wheat, rice, pulses, shrimp from around 40000 villages . It intends to take this facility to 15 states in the future covering 10 million farmers and 100000 villages in the coming years.

Issues in the Distribution system

With the inflow of retailers like walmart, ITC would be in a new arena altogether. With its competitiors like HUL having prior experience of working in company specific channels with shared ERP tools, ITC would have to device new distribution channel to account for such retail players.

ANALYSIS OF MARICO'S DISTRIBUTION NETWORK

Supply Chain Strategy

Marico[2]produces 125SKU's in its own seven factories and 15 sub contracting manufacturers. It has two consolidation/redistribution centres to manage logistics activities and stores products in 32 warehouses which in turn supply to more than 3500 distributors. The distributors supply to around 1. 6 million domestic retail outlets. In addition Marico has distribution alliance with Indo Nissin Foods and a distribution agreement with P&G. Throughout 90's Marico maintained a robust growth but with increased rivalry it started facing pressure and was unable to sustain the performance of its supply chain as its scale of operations grew. A smooth functioning supply chain is crucial if businesses are to survive in competitive markets. Marico's biggest challenge was to create efficiencies in distribution, which is the area of greatest competitive advantage that can be achieved in India.

Supply Chain Challenges faced by Marico

The main issues faced by Marico were to deal with the fragmented nature of India's retail sector and the geographical reach of the markets. Moreover though Marico supplied to more than 1. 6 million retail outlets, 95% of the retailers were kirana stores. The supply chain consists of a number of business components (Refer Exhibit 17).

Marico ships all its fast-moving SKU's directly from the plant to the depots and its slow moving SKU's first to the redistribution centres from where it is shipped to the depots. Such a model created logistical issues . Moreover Marico being in a growth stage, it came up with new products and brands on

a continuous basis which resulted in an increase in the accountability of more sales, more markets and SKU's to be tracked, more forecasts to make and more truckloads to configure and route (Refer Exhibit 18).

In the late 90's Marico started facing problems in its planning and forecasting due to a lack in its internal and market visibility. Marico faced problems in integrating the operations of its various processes because it was primarily operating in standalone systems controlled from the headquarters and each of its then existing 30 depots. So basically they were not integrated with each other and entire planning was done in excel leading to a lack of data visibility and inconsistent management reports which lead to inaccurate forecasts, long planning cycles, lack of transparency of warehouse stock and delayed customer response.

Internal Operations

The use of excel proved insufficient as the data gathered from production and sales were reviewed on a monthly basis and if there were any changes pertaining to the market within that period it was impossible to change the production plan. The sales department often used their personal relationship to influence the production scheduling and distribution planning which lead to a lack of integrity of the entire supply chain creating more problems.

Market Visibility

Marico mainly followed a push strategy. It was severely cumbersome to collect primary data about the sales figure from retailers as 95% of retailers were kirana stores. So the only way out was to gather data of distributor sales to retailers which was highly time consuming on the unavailability of

proper information technology. This lead to synchronization problems between manufacturers and distributors as already they were using different time horizons of planning: 2 weeks for production and 1 week for distribution. The net outcome was high stocks in the supply channel and low service levels.

Distribution

Marico also faced a major concern regarding its distribution policies. Due to a lack of information regarding the stock levels in depots sometimes managers had to rent temporary spaces due to lack of space and at other times there were stock outs in the depots (Refer Exhibit 19).

Some of the crucial overall operation strategy problems faced by Marico were (Refer Exhibit 20):

Demand Uncertainty

Demand volatility is distorted and amplified along a supply chain known as Bullwhip effect. Another is Clock speed amplification which is a phenomenon that manufacturers face in a decline in price/performance ratio and compression of product life cycle as they are placed closer to the consumer end of the supply chain (very true for a FMCG industry). So firms need to adjust the speed of their internal operations to meet the accelerating external clock speed.

Forecast volatility

Demand information is highly volatile from customer side as either they are inflated or deflated.

Confidentiality

Vertical information sharing for e. g.: transmission of point-of-sales data between a retailer and manufacturer has both a direct and indirect effect (leaking information to other competing firms)

Demand distortion

Information transparency among all members of the supply chain reduces demand distortion

Speed

In order to reduce throughput time speed of information travel has been critical to the firms.

Demand sensing

Demand signals based on chaining patterns in demand pattern can be developed by means of alert systems thus making the supply chain more agile, flexible, predictable and profitable

Sales Force Automation

Conceived as an electronic method to collect and analyze customer information from marketing and warehouses and which can be used for customer retention and acquisition as well as enhance marketplace relationships and revenue.

Virtual Integration

Virtual integration enhances information sharing and thus helps to maintain better process control and demand volatility. With the help of IT all partners in a value chain feedback mechanism can be installed which helps in greater

inter-firm collaboration. Thus virtual integration enhances both downstream and upstream visibility and reduces the influence of environmental uncertainty.

The next section explains how the above challenges were addressed by the implementation of an ERP system extended to include all business partners.

The challenges faced in FMCG companies are compounded when the number of brands and markets expand. This was the case with Marico where a large volume of sales in varied markets required a large number of SKUs to be tracked, forecasting, production planning along with designing distribution schedules. The entailed a shift from traditional methods of capturing data in independent systems and excel sheet which essentially caused the following problems:

Stand-alone applications with non-integration: Departments with conflicting data

Forecasting accuracy only 70%, distributor stock out stood at 30%, excess inventory and loss of sales due to errors in shipment to remote depots

Data Gathering, production planning and final production plan schedule took 30 days

To optimize forecasting and distribution networks for efficient delivery mechanism, an ERP implementation was envisaged which would integrate the internal processes as well distributors’ systems.

VMI Philosophy

Vendor Managed Inventory is an integrated approach in which the inventory of the distributor, retailer or customer (downstream) is monitored and managed by the manufacturer (upstream). This main idea is to create an integrated supply chain mechanism resulting in a sustainable competitive edge. Marico planned to extend its IT implementation not only to streamline its internal processes but also consolidate its value change by implementing a VMI solution.

ERP Implementation

Marico was initially using disparate legacy systems and the transition to a complete end to end ERP system required considerable investment as well as acceptability in the company. The roadmap laid out for this process in 1999 consisted of five stages project preparation, business blueprint, realisation, final preparation, go live and support to be completed by the year 2001. The customization required in the tool was suggested not only by the technical team but the employees and various functional heads that had insights into the key problem areas during operation. The idea was to implement a solution which could provide company wide integration but at the same time was well equipped with the need of employees at the operational level.

The final system was implemented in phases and consisted of SAP R/3, APO and BIW, and MIDAS and this initiative was furthered by development of a B2B portal MiNet to reach out to distributors (Refer Exhibit 21).

MiNet – SCM tool

Marico information network forms the backbone linking various business components and partners. It is a portal with access to 800 distributors and 110 super distributors of Marico spread across the country. Super distributors are distributors for rural areas who sell to the stockists who further connect to the retailers. This network thus, connects to 330 distributors which accounts for about 75 per cent of company’s sales.

At the backend installed is the SAP R3 transaction handling modules for sales, finance and materials management. The company has also installed the Advance Planner & Optimizer (APO), a supply chain module, which works right from demand forecasting to materials management and production planning. Marico claims to be the first APO installation for SAP in India.

Finally, the company has in place a business information warehouse (BIW) which is the repository of every bit of information relevant to the company. This backend is linked to the outside world comprising scores of business associates through MiNet.

The primary sales primarily done by the depots or C&F agents have also been enabled by this system. These depots are connected via VSATs (very small aperture terminals) or a virtual private network at Marico’s expense. The secondary sale done by the distributors is also captured using the MIDAS application and connected to t