

# THE MAIN METHODS USED IN THE SELECTION AND SUBSTANTIATION OF DISTRIBUTION STRATEGIES

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**Abstract:** *Based on an economic model, some comparisons have been made between distributional costs for two kinds of circulations: one long, employing agents, and another short, organized only with personal resources of the reviewed company. The model takes into account the nature and costs for each kind of circulation as well as the structure and nature of activities and responsibilities of each partner through the distributional strategy employed. This reveals the fact that employing one personal distribution circulation - vertical distribution system – is more efficient than the distribution by means of agents only when it starts with a certain level of the amount, and is more convenient in the long channel where the agent pays a large part of the fixed costs.*

**Key words:** *distribution channels, economic calculus, the cost of a distribution circuit.*

## 1. Introduction

One of the strategic business issues is the choice of distribution system, provided it actually involves strategy of integration into a circuit or system of circuits with the obligations, the consequences arising from this relationship. Choice of variants of distribution must be well-founded, with first choice in weighing the advantages of a circuit and on the other, the drawbacks or limitations which they impose. According to experts opinion, to the choice of distribution strategies contribute more aspects which include: category of intermediaries acting in different areas of the market, the number of circuits that can be obtained as strategic alternatives; the size of distribution circuits, the nature and degree of specialization of the Marketing channel used, the structure of each channel and the degree of selection of distribution,

the rights and obligations of each participant in the distribution system; the implications on strategic alternatives over the management process of the company.

Among the issues that define the background of distribution strategies, the most important coordinates are: determining the structure of the distribution circuit to be adopted and the type of relationships to be established and maintained by intermediaries; identification and clear indication of the intensity and concerns of market coverage; the structure of communication tactics to be adopted in relations with intermediaries and with intermediary or end users. To these issues other elements, such as calculation of economic and management issues, are added in the substantiation process - particularly those on the control and the possibilities for

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adaptation. Strategic thinking begins with setting objectives for distribution.

They are derived from strategic marketing objectives, which in turn arise from the overall development strategy of the company. The objectives of the strategy of distribution usually concerns: choosing a distribution channel for each segment of consumers; adapt to market conditions; reduce the cost of logistics; eliminate conflicts in the distribution channel; to exercise control in the distribution channel. Diversification of marketing format, the width of marketing assortment and territorial coverage are also elements that plays an important part in defining the strategy of distribution. Determining the structure of the distribution to be adopted is one of the main elements on the background of the distribution strategy. In this respect, at least in theory, managers have a choice between a direct distribution system, without intermediaries and a system that will involve a larger or smaller number of intermediaries. In the modern economy, producers are however, often forced to use intermediaries. If we talk about indirect distribution, an important element in the strategy of distribution is the type of cooperation existing between the intermediaries, depending on the type of vertical structure.

Regarding the second "pillar" that the distribution strategy is based on, determination and a clear indication of the intensity of concerns for covering the market, it is considering strategic options to be present in an area as large as possible on the market and closer to the end user.

In general, the factors that influence the directions of development of the distribution companies are related to: the evolution of consumption and consumer behaviour, the capacity to cover the market through an intensive distribution, selective or exclusive but also issues related to

commercial legislation, strategies adopted by competitors.

## 2. Economic Calculation

Economic calculation, evaluation of marketing costs of the different volumes of goods, through the various types of circuits or channels of distribution, proves to be one of the most important aspects involved in the substantiation process because each strategic option will lead to different levels in terms of sales and costs. Managers are required to determine whether using their own sales force or contrary to one or more intermediaries, the organization can achieve a higher volume of sales and better relative costs.

The cost of a distribution circuit is measured by the margin distribution, which represents the difference between the selling price to the final user or consumer and producer price paid to producer. The margin distribution is so identified with the concept of value added by distribution, for distribution circuits - short, medium and long - in which more intermediaries are involved, the margin of distribution is the sum of successive intermediary's margins. The margin of a participating dealer in the circuit is the difference between selling price and the price at which it buys. When the circuit is made by a single intermediary, the two concepts overlap.

The margin distribution is expressed usually as a percentage, or in relation to the sale price to the consumer - the public price, either in relation to the purchase price. Depending on the two possible situations - the public price or the purchase price taken as the basis of reporting - two types of retailer margins are calculated: outer margin and inner margin. In substantiation of distribution strategies the inside margin is commonly used.

Distributor margin in absolute values is calculated this way (Figure 1):

$$\mathbf{MD = P - C}, \text{ where}$$

$$\text{MD} = \text{distributor margin} \quad (1)$$

$$\text{P} = \text{selling price}$$

$$\text{C} = \text{buying cost}$$

Distribution margin also can be calculated as a percentage this way (Figure 2):

Further, based on an economic model, some comparisons are made on the costs of distribution and types of circuits and on the logistical elements of each type of circuit. In Table. 1 is an example of computing in order to compare the two types of distribution circuits - short and long term.

- *Calculation of percentage distribution margin:*

$$\text{- outside -} \quad \text{- inside -}$$

$$MD^* = \frac{P - C}{P} (\%) \quad MD^o = \frac{P - C}{C} (\%)$$

(1)

- *Rule or principle of equivalence*

$$MD^* = \frac{MD^o}{1 + MD^o} \quad MD^o = \frac{MD^*}{1 - MD^*}$$

The example presented is based on data provided by PLP Group Company located in Braşov. The company distributes automotive tires and batteries through a distribution network covering about 85% of Romanian territory using several types of distribution channels from which I choose for comparison two variants: short circuit, comprising: Importer (PLP Group) by your own service - Consumer and long circuit comprised from Importer (PLP Group) - sales agents - independent shops - Consumer. The model takes into account on one hand, the nature and costs on each circuit, and on the other hand, the structure, the nature of duties and responsibilities that each partner has in the distribution strategy adopted.

It can be seen how, in the analysed long circuit, most of the functions of physical distribution - logistics - are provided by sales agents (en-gross) and, therefore, relative costs are higher, commensurate with the turnover of the producer, also covering the retailer margin. The manufacturer may be content just with the management of sales and with limitation of relations with agents. Instead, fixed costs

are, in this case, very small for the manufacturer. If short-circuit distribution can be seen, on the contrary, that the fixed costs become preponderant. The manufacturer has to assume this time logistics functions of storage and transport, to provide a network of warehouses and a sales management more important and more laborious. Expenses generated by the management of stock and customer accounting, contact and information functions are also provided by the manufacturer.

In the analyzed company, the turnover on each circuit of distribution is around 550.000 lei, in which case, as may be established using the diagram, longer channel is more effective. Only if the company had a turnover of more than 950.000 lei situation would change, becoming short channel efficiently.

Analysis of this model may delineate a conclusion that small businesses should use strategies based on long distribution circuits, their turnover is in general too small to support investment and fixed costs arising from a short circuit.

The graph of the two cost functions are shown in circuit Diagram 1.

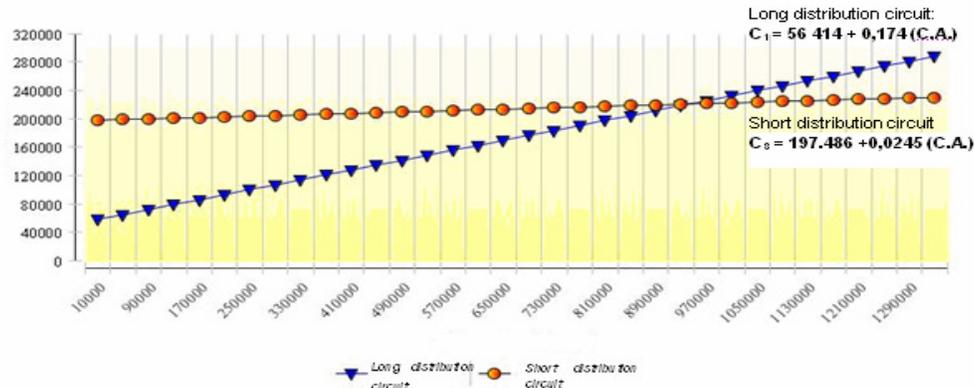
*Comparing costs of two distribution circuits*

**Table 1**

<b><i>Long distribution circuit: importer – distributors - independent shops - consumers</i></b>		<b><i>Short distribution circuit importer through own services - consumers</i></b>	
<b><i>Costs</i></b>	<b><i>Explanation</i></b>	<b><i>Costs</i></b>	<b><i>Explanation</i></b>
<b>Transport</b> -	<ul style="list-style-type: none"> <li>• I → G : Task of I</li> <li>• G → D : Task of D</li> </ul>		<ul style="list-style-type: none"> <li>• I → warehouses Task of I</li> <li>• warehouses → D: Task of D</li> </ul>
<b>Sorting</b> - <i>Covering agent margin 15,2 % of producer turnover</i>	<ul style="list-style-type: none"> <li>• Task of G and D: full range</li> </ul>	-	<ul style="list-style-type: none"> <li>• Task of D risks a less complete range</li> </ul>
<b>Stocking</b> -	<ul style="list-style-type: none"> <li>• warehouses: task of G</li> <li>• stocks: task of G</li> </ul>	97486	<ul style="list-style-type: none"> <li>• 3 service</li> <li>• 8 turnovers per year (46 days speed)</li> </ul>
<b>Contracts</b> -	<ul style="list-style-type: none"> <li>• clients: task of G</li> <li>• risks: task of G</li> </ul>	1.25% of turnover.	<ul style="list-style-type: none"> <li>• payment at 45 days</li> </ul>
<b>Information</b> 2.2% from turnover	<ul style="list-style-type: none"> <li>• requires pressure strategy over G and D</li> </ul>	1.20% of turnover.	<ul style="list-style-type: none"> <li>• strategy to absorb</li> </ul>
<b>Sales Management</b> 56 414	<ul style="list-style-type: none"> <li>• over the task of G a small team</li> </ul>	100.000	<ul style="list-style-type: none"> <li>• over the task of I a strong team</li> </ul>
<b>Total cost</b> 56 414 + 0,174 (turnover)	<ul style="list-style-type: none"> <li>• cost is relatively commensurate with the work</li> </ul>	197.486 + 0,0245 (turnover)	<ul style="list-style-type: none"> <li>• the fix costs part is important</li> </ul>

In connection with another very important coordinate in substantiation of distribution strategies that is the management issue specific to substantiation of the distribution strategies, the control issues should be stated that involves the evaluation of the results of applying each strategic choice taken. Given that in a distribution circuit are forces that can act and have interests and actions meant to counteract or lessen the intensity of the interests of some of the

companies within the marketing channel the marketing channel to maximize profits detrimental to the economic organization involved. A particularly important role in this case is tracking the concentration, distribution and staggering of promoting efforts and sales insuring with appropriate clauses included in the partnership acts, the client approaching, and contracting system, storage systems, assorting and presentation of products and the development of payments program.



**Diagram 1.** Comparing the functions of the two distribution circuits

Data were processed and are presented graphically using SanCont system, provided by the company SAN Software of Braşov

The last reviewed criterion, but also a very important one in substantiation of the distribution strategies, is the possibility of adapting to the requirements of the particular circuit. To form a channel, members are obliged, for a certain period of time, to assume a number of mutual obligations. This inevitably leads to decreased ability for the organization to independently react to changes in the market. Therefore, the company should opt for those marketing channels to enable a maximization of the possibilities of control and inspection, as well as own capabilities to quickly adapt the marketing strategy to market conditions and requirements.

The decision concerning the training, the implementation and the development of a vertical distribution system or the one regarding the affiliation to one already formed must consider its advantages and disadvantages and costs. The following research shows how we can draw conclusions that organizing a vertical distribution system attracts, amongst members of channel, in the case where the production volume is large enough, a considerable number of advantages, as

well as restrictions that participants need to obey.

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