

Re-Common Sense Drives the Distribution Industry

— Reforming the Distribution Industry by 2010 —

Noriaki HINO

Nomura Research Institute

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The distribution industry is suffering from a slump in profits, and each company is striving to reform its business in order to restore profitability. If we consider future changes in the management environment, however, there are actually very few opportunities to recover profits by conventional means. From the mid- and long-term perspectives, this will require drastic reforms to stabilize management.

For these purposes, optimization should not be limited to within a single company, but must instead be applied throughout the supply chain if profits are to be made. Doing so is expected to increase the profit ratio by 7 percent.

The goal of total optimization is to reduce those costs in the entire supply chain that have their origins in Japanese business practices. This kind of restructuring is called “re-common sense in distribution.” The worldwide introduction of GDS (enabling the sharing of product information) is another chance to introduce “re-common sense in distribution.”

By 2010, the Japanese distribution industry is expected to have adopted the spiral-type restructuring common in the US and especially in Europe, although in a form that is uniquely influenced by the demands of Japanese business. In the future, the relationship a company has with the channel captain will be vital for managing the distribution business. This is because that relationship will be the driving force in restructuring the distribution business. In addition, we will have to prepare IT platforms and scientific ways of doing business as well as establishing a new kind of governance.

“Distribution” is the process by which a product travels from a manufacturer to the consumer, and wholesalers and retailers involved in this process are collectively referred to as those engaged in the distribution industry. This paper examines the distribution situation overseas, considers the current problems facing the distribution industry, attempts to forecast the form that the industry will have by 2010, and describes the survival strategies available to retailers.

I The Struggling Distribution Sector

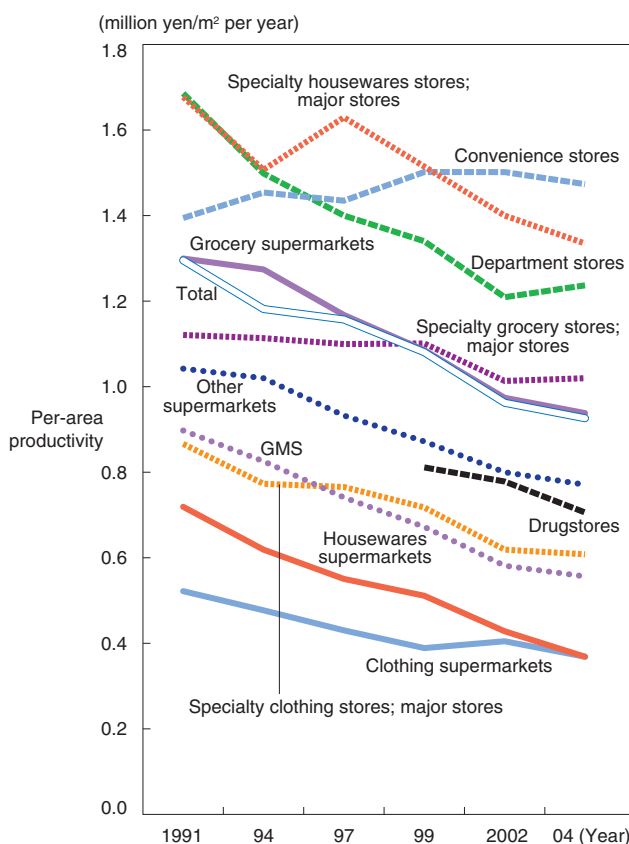
Currently, the traditional players of the distribution industry, namely retailers, manufacturers and the wholesalers that link them, are all facing problems of their own.

1 Limits of the Traditional Growth Model in the Retail Business

If we look at recent performance figures for the retail sector, even food supermarkets, which have always been thought of as having excellent stability, are experiencing reduced profits. Department stores and general merchandising stores (GMS) are also suffering from a drop in the number of customers. Accordingly, in order to maintain their profits, they are applying internal measures such as minimizing their inventories and restraining personnel costs.

The entire retail sector faces a reduction in purchases per customer (as caused by deflation), an excess number of outlets and a drop of customer traffic as other types of stores increase their competition. The issue of an excess number of outlets is apparently reflected in per-area productivity (sales per unit area of floor space) that has continued to fall (Figure 1).

Figure 1. Trends in Retail Per-Area Productivity by Type of Business



Source: Compiled based on "Census of Commerce" published by the Ministry of Economy, Trade and Industry.

The growth model adopted by the retail sector to date has depended on continuing to open new stores so as to increase the scale of operation and profits, rather than aiming at increasing the sales volume in existing stores. With the reduced per-area productivity caused by the excess number of outlets, however, the traditional growth model is about to collapse. Every company, therefore, is making internal efforts to reduce costs and boost profits, while at the same time revamping their frontages to create NSCs (neighborhood shopping centers) and LSCs (lifestyle shopping centers) in an attempt to increase sales.

2 Reduced Manufacturer Presence

Prior to the high growth period, the distribution market was dominated by manufacturers. Each manufacturer controlled its own downstream distribution channels with sole agent and agency agreements, and was able to enjoy profits by affiliating its wholesaling and retailing channels.

Subsequently, while manufacturers maintained their relationships with affiliated retailers, they also expanded transactions with large-scale retail organizations such as supermarkets, convenience stores and chain stores. As a result, the major retailers have expanded their presence based on their considerable buying power and volume discounts given by the manufacturers.

However, the volume discounts gave the major retailers the ability to drop their prices. This situation led to a vicious circle with the manufacturer's affiliated retailers being undermined, and with very little profit being made from the major retailers.

3 Appearance of Affiliated Wholesalers

According to the "34th Japan Wholesaling Survey" undertaken by the Nihon Keizai Shimbun, the overall operating profit of the wholesaling sector (13 fields including pharmaceuticals, food and textiles) in fiscal 2004 was down 10.8 percent compared to the preceding fiscal year. Regional wholesaling was particularly hard-hit, being down a massive 27.1 percent from the year before. The sectors upstream and downstream of the wholesalers (manufacturers and retailers) have been placing pressure on the wholesalers. For example, it has been reported that the usual profit in food wholesaling is only 0.3 percent after tax, demanding very careful management in order to maintain a profit (*Nikkei Marketing Journal*, August 3, 2005).

Given this environment, wholesalers began to form alliances in order to survive.

For example, in October 2005, pharmaceutical wholesaler Mediceo merged with Paltac, a wholesaler of daily necessities, to form Mediceo Paltac Holdings Co., Ltd. Also, in the field of cosmetics and daily necessities, Arata Corp. will merge with Chuo Bussan and SISCO in

October 2006. (Later, Chuo Bussan left the planned merger.)

With the current difficult business environment, such alliances seem set to continue. In the general goods and pharmaceutical fields, for example, there is now an oligopoly controlling more than 60 percent of the market (combined total for the top five companies).

In food wholesaling, also, April 2006 saw the announcement of a tie-up between the largest wholesalers, Kokubu and Mitsui Foods, which came as a major surprise to the market. It is also worth mentioning the sequence of related events up to this point. In 2004, confectionary wholesaler San-Esu Inc. failed due to securities transactions, giving Mitsubishi Corp. the opportunity to move in and bail out San-Esu. Subsequently, the entire industry began to surge toward restructuring.

Finally, we are at a stage where a complicated relationship is seen between general trading companies and major retailers, with alliances between local wholesalers becoming common, and general trading companies taking wholesalers under their wing. While the situation was that industrial restructuring could take place at any time, it only took one small event—like a thread breaking under a strain—to set up a completely new aspect for the industry.

II Retailers Exposed to Adverse Conditions

The environment surrounding retailers—the ultimate players of the distribution industry—is undergoing major changes such as a falling population and the aging of society. In addition to these changes, the industry faces other difficulties. This section examines the factors that have a major influence on management.

1 Revision of Three Town-Planning Laws Places Constraints on New Stores

Among the so-called three “town-planning laws,” which regulate the construction of large stores in the suburbs and promote the regeneration of city centers, the City Planning Law amendment bill, and the Central City Invigoration Law amendment bill were passed by the National Diet in May and June of 2006. These amendments will come into full effect in fiscal 2007 (the third law is the Large-Scale Retail Store Location law).

The City Planning Law amendment bill, which divides land use into six types, now prevents stores with a floor area of more than 10,000 m² from being built in “Type 2 residential areas,” “quasi-residential areas” and “industrial areas.” To date, large-scale retailers have been able to build stores in these kinds of areas.

Furthermore, according to the Central City Invigoration Law, businesses must obtain approval from the government to build stores in “semi-industrial areas” in local districts. Therefore, once these new regulations come into

effect, it will only be possible for large-scale businesses to build new stores with floor areas of more than 10,000 m² in two types of areas, namely “neighborhood commercial areas” and “commercial areas.” Relative to the current situation, this constitutes only 25 percent of the area of the six types that were previously available for construction.

Furthermore, although these revised laws are scheduled to come into effect in fiscal 2007, moves have already been taken to apply these revised laws before fiscal 2007 at the local government level in the form of ordinances and administrative guidance. Thus, new store development is already being restricted.

2 Increases in Interest Rates Have a Major Effect on Retailing

In March 2006, the Policy Board of the Bank of Japan decided to lift its policy of quantitative easing. In the financial market, in anticipation of a turnaround in interest rates after economic recovery, the government bond yield and long-term prime rate began to be increased at the end of 2005.

While economic recovery is, in itself, welcomed by retail management, the rise in interest rates that the recovery will spur are likely to work against the retail sector. Over the last few years, the major chains have led investment in new store development and remodeling, with their interest-bearing debt either increasing or remaining stable. With low interest rates, this was not an issue, but future increases in interest rates are likely to adversely affect company profits (Figure 2).

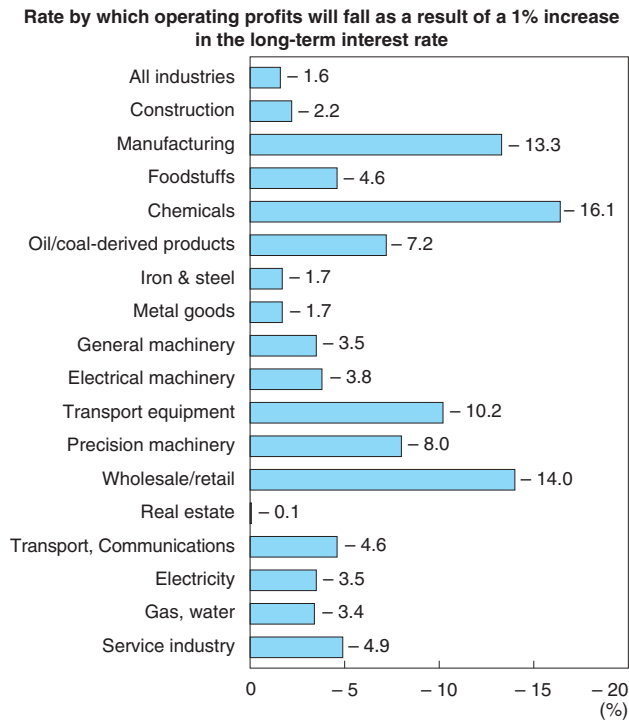
3 Increased Competition for Retail Staff and Higher Personnel Costs

At retail stores such as GMSs (general merchandise stores) and supermarkets, part-time labor is used extensively to increase cost competitiveness. In major chains, part-time workers constitute more than 70 percent of the workforce. With the economy resuming growth, however, it seems that all areas of business are experiencing a labor shortage, with retail being particularly hard hit. It has become difficult to secure sufficient part-time and casual labor.

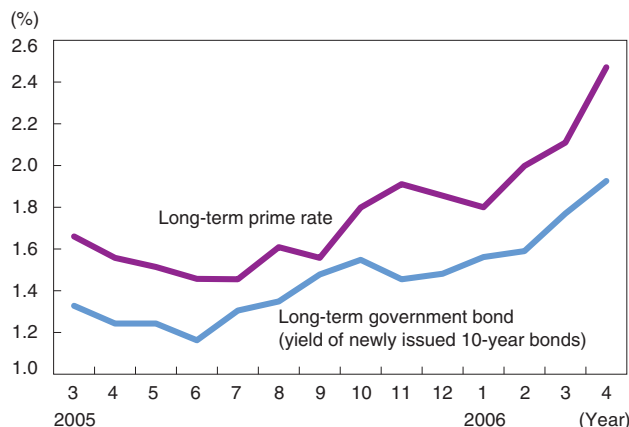
In November 2005, the Fair Trade Commission introduced its new rule for “further preventing the abuse of predominant position by retailers.” Prior to the introduction of the new rule, entrusting the display of products to suppliers was not seen as an abuse of position, but bringing this work in-house led to a shortage of people capable of doing it. Faced with this situation, the retail industry has to rely on dispatch companies that charge high hourly rates to provide personnel, which greatly increases personnel costs.

In addition to part-time workers who engage in store operations, a difficult situation has also emerged in

Figure 2. Influence of Interest Rate Increases (By Industry)



Interest rate trends



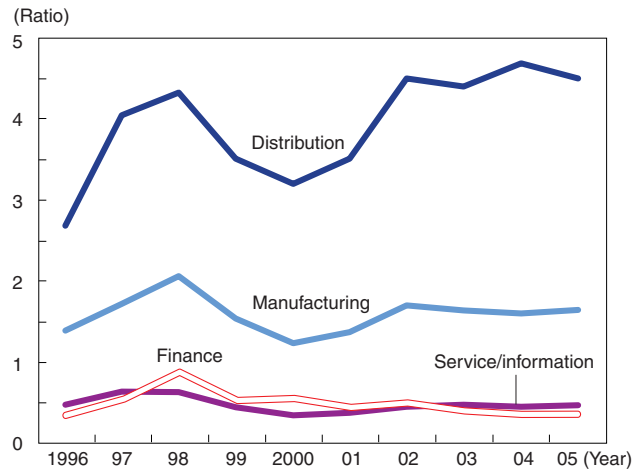
Source: Compiled based on "Financial and Economic Statistics Monthly" published by the Bank of Japan and "Simulation of Japan's Economy over the Next Ten Years" published in April 2005 by the Committee on Economic Policy of Keizai Doyukai (Japan Association of Corporate Executives).

securing regular employees who are expected to serve as core personnel according to the company's mid- to long-term plans. As shown in Figure 3, the ratio of distribution industry job offers made to university graduates (total number of persons offered a position divided by the total number of jobseekers) is much higher than in other industries.

Accordingly, even if we consider all the assumed upcoming environmental changes, it is hard to imagine that the external environment will be such that it provides the impetus to drive the entire industry forward. On the contrary, the management environment is expected to become even more demanding.

The retail industry can be said to be highly dependent on the environment. Actually, in the past, it has often

Figure 3. Trends in Job Offers Made to University Graduates (By Industry)



Notes: (1) Ratio of job offers to seekers = total number of persons offered a position divided by the total number of jobseekers in the private sector. (2) Based on job offers made to university graduates in March of each year. Source: Compiled based on "College Graduate Recruitment Survey" by Works Institute, Recruit Co., Ltd.

achieved success by successfully responding to the socioeconomic environment. Sometime around 2010, a turning point is expected when the environment will change once again, as has often occurred in the past. As such, we must soon adopt a new business model.

III Accelerated Trends towards Overall Optimization of the Supply Chain

Therefore, what points must we consider when examining a new business model? The necessity to secure consumer support is obvious and, regardless of the times, we must provide "good quality products at low prices and with convenience." Recent trends have included the traceability of foodstuffs to ensure safety and security, the provision of organic foodstuffs, business reforms and the introduction of unmanned checkout counters to cut costs, enhanced service and "future stores" (stores that make full use of IT).

However, few people consider that these efforts alone will overcome any major obstacles in the industry's success in the future. That is to say, it is more likely that so-called homogeneous competition will arise with much the same sense of despair as is prevalent now.

Accordingly, efforts will be made to break out of the shell of the conventional style of reforms implemented within a single company (such reforms pursued only partial optimization in view of the entire supply chain) and to pursue optimization covering the entire supply chain, i.e., overall optimization. The following section examines why increased attention is being given to this concept of overall optimization.

1 Conventional Practices Are Out of Touch with the Era

As described above, the former distribution system in which wholesalers and retailers were all affiliated with a manufacturer featured a system where the manufacturer determined the retail prices and the system of rebates (the rebates would increase as the retailer sold more and more of the manufacturer's products). These systems served to ensure the presence of the manufacturers. In addition, the following practices were commonplace.

- **Delivered cost:** System whereby the cost included delivery to the retailer by either the manufacturer or wholesaler
- **Standard forms:** Industry-wide system whereby prescribed forms are used to control the purchase or return of products
- **Agency transaction:** System whereby the products of any one manufacturer can only be acquired from a given wholesaler
- **Center fees:** System whereby manufacturers and wholesalers who deliver products to a distribution center set up by retailers pay a fee to the retailers for using the center.
- **Product registration fees:** System whereby a manufacturer or wholesaler pays a registration fee to have data on their new products registered in the retailers' systems.
- **Consignment sales:** Originally, this meant a system in which the ownership of the products was not transferred to the retailer. However, in actual usage now, this means a system where any unsold products are to be returned to the manufacturer/wholesaler.
- **Dispatched sales staff:** System whereby a manufacturer or wholesaler dispatches sales staff to a retail outlet at its own expense with the purpose of promoting the sales of the company's products.

Part of these trade practices functioned effectively and provided a valuable means of generating profit to each market player in the era when manufacturers maintained a presence and played the role of adjusting the profit of each player in the distribution process.

However, with the rise of powerful "category killers" that drove out other stores operating in the same category, with the appearance of global retailers and with players coming from outside the "village" that was the market in the past, competition among retailers has greatly intensified. As a result, the ultimate supply chain price (as paid by the consumer) has been removed from the control of the manufacturer and has fallen, such that all the players in the supply chain have seen their profits fall.

The supply chain of the past, in which leadership flowed from upstream to downstream, has been supplanted by a chain where the power balance has been completely reversed. Trade practices that functioned well

under the leadership that flowed from upstream to downstream now work in the opposite direction under reversed leadership, impairing the profits of each player. The downstream parts of the supply chain now tend to pursue profits that are within reach, while looking for reductions in costs and requesting special treatment from upstream. As a result, the overall costs incurred by the entire supply chain have been increasing.

If we were to ask "What's wrong with Japanese-style business practices," a quick answer would be that "every player in the supply chain incurs unnecessary costs."

2 Problems with Japanese-style Supply Chains

For example, the delivered cost system, described above, defines the cost of a product as delivered to the retailer, such that the price includes the cost of delivery. Therefore, the manufacturer's cost increases if a retail outlet requests frequent deliveries.

Because the manufacturer must generate a profit from transactions with the retailer, the extra costs incurred by frequent deliveries will inevitably affect the price of the products. From the retailer's point of view, frequent deliveries help reduce the risks related to holding inventory, as well as related costs, satisfying the retailer. In reality, however, other costs (product costs) actually increase. The manufacturer is not deriving profit by adding to the cost of a product. Rather, the costs related to facilities and inventory in preparation for unanticipated orders tend to increase.

Similarly, the standard forms system is out of touch with current conditions. In the 1970s, these forms came to be standardized, and were known as "chain store standard forms" or "department store standard forms." Then, in the 1980s, because of the proliferation of different terminals caused by the need to provide each trading party with individual terminals, a standardized data exchange format called the "J protocol" was adopted.

However, the coming of the 1990s saw a change in the type of data that had to be exchanged between companies, resulting in each company creating its own forms. For example, electronic commerce (EC) required the provision of specifications when products were sold. However, the type of data varied immensely depending on the manufacturer, forcing retailers to manually adjust the data to conform to their own formats. As a result, we now have a situation where there is no standard format and, instead, each company has created its own version, leading to a huge number of different formats.

3 Maintaining Competitiveness Through Overall Supply Chain Optimization

Until now, each of the players in the distribution field aimed to increase their competitiveness by reducing costs or increasing their buying power, again to reduce

costs, and all had basically achieved certain results. However, as suggested by the term “homogeneous competition,” the entire distribution industry has suffered, as described above. In the words of one person in the distribution industry, the current state of the industry is “akin to getting blood from a stone.”

Consequently, we can say that reducing costs for the entire supply chain will enable each company in the chain to benefit. A company should not aim to optimize only its part of the supply chain. The ultimate goal is to optimize the entire supply chain (all the players making up the chain).

According to research undertaken by the Ministry of Internal Affairs and Communications, total optimization of the supply chain could realize a savings in sales and administrative expenses equal to 7 percent of gross retail sales (Nomura Research Institute “4th Meeting Concerning the Future Vision of Collaboration in Consumer Product Distribution,” November 2003).

In other words, the potential is there to increase sales by 7 percent. For retailers that have to work with profit margins of around 1 percent, a 1-point increase in profit would make a huge difference. Optimization of the entire supply chain would have an enormous effect.

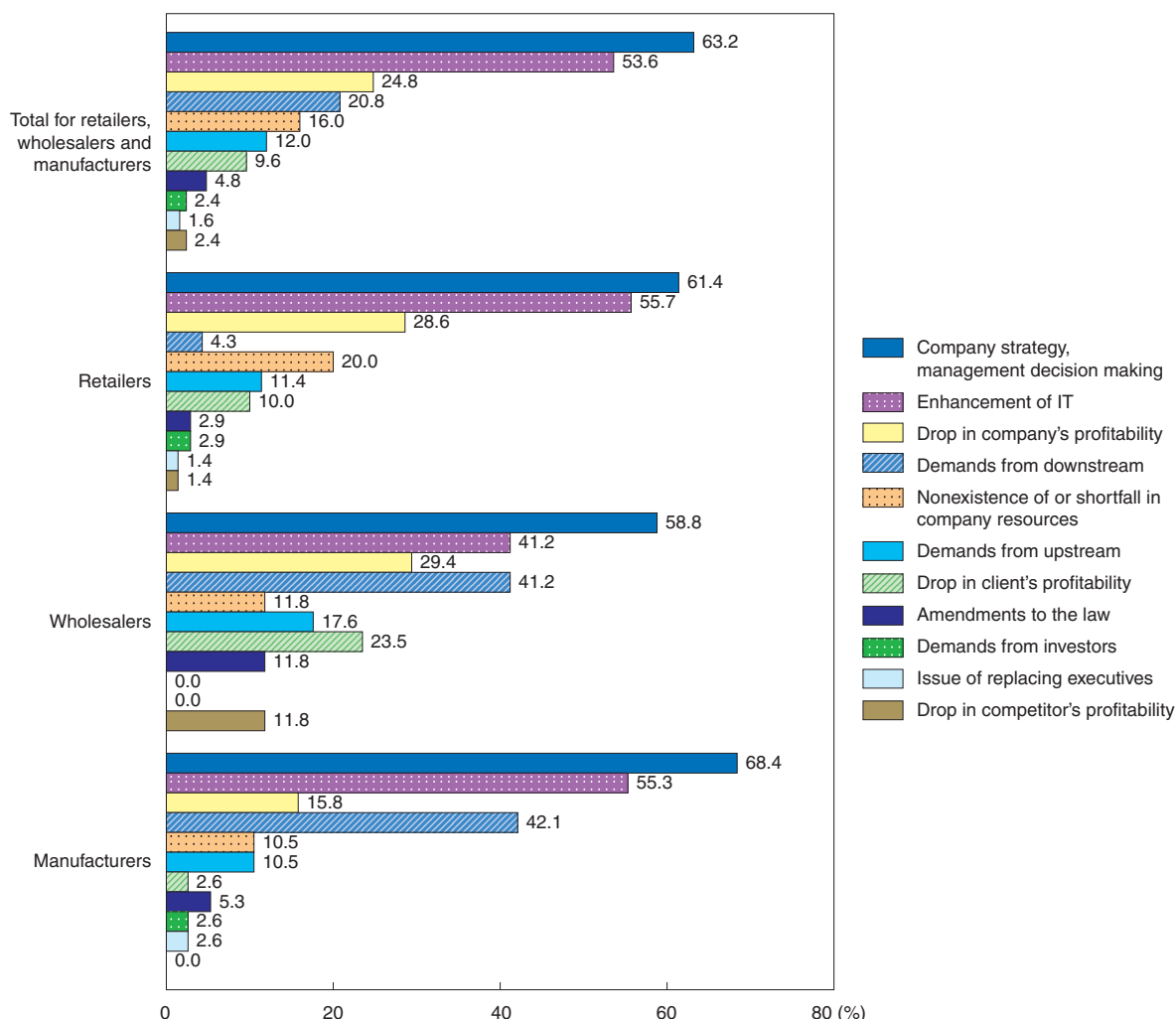
4 Using GDS to Optimize the Entire Supply Chain

How, then, can we begin to go about optimizing the overall supply chain?

NRI conducted a questionnaire survey of the Japanese distribution industry in cooperation with the Japan Retailers Association (“Questionnaire Survey on the Future of the Distribution Industry in Japan,” March 2006). The survey revealed that the most important factor affecting cooperation based on the supply chain is thought to be “management decision making” followed by “IT enhancement.” In other words, respondents see that overall optimization will be facilitated by changing conventional customs and ideas and with IT support (Figure 4).

Given the key concepts of “management decision making” and “overall supply chain optimization,” we are prompted to remember the famous canoe trip made by the presidents of Wal-Mart and P&G. On this trip, they talked about various aspects of management, cast doubt on former common sense and came to regard hostility in business transactions as useless. The two came to have the same opinions and forged a new partnership. The

Figure 4. Conditions Deemed Important to Promote Vertical Cooperation by Companies in the Distribution Industry



Source: “Questionnaire Survey on the Future of the Distribution Industry in Japan,” a joint survey by Japan Retailers Association and NRI, March 2006.

success of Wal-Mart Stores can be traced back to this trip. System change, as well as new products and new technologies, did not trigger this success. Instead, such success has its origin in emotion. An interesting take on this, even from the perspective of management history, is that the opportunity was presented by changes in the awareness of company executives.

If we look at the future of the Japanese distribution industry, we find that an event planned for 2007 will present a great opportunity for changing the mindset of company executives, as well as for “enhancing IT” in the industry. This event is the introduction of the mechanism called GDS (Global Data Synchronization) in which multiple product databases are interconnected through the Internet. GDS enables the use of multiple databases as if they were a single information source. This mechanism not only improves the efficiency of the information interchange between manufacturers, wholesalers and retailers that up until now has been done either electronically or on paper, but also enables the sharing of product information regardless of the scale of the enterprise.

In Europe and the United States, thanks to the lead taken by major consumer goods manufacturers and major retailers, GDS has already been implemented. In countries throughout Asia, work is underway to introduce the technology. This is a global trend and, as such, is being promoted and supported in Japan by the Ministry of Economy, Trade and Industry.

In 2006, a total of 62 manufacturers, wholesalers and retailers took part in verification tests. As a result, implementation work is planned to start in 2007, with a “national data pool” linking individual data pools going online in 2008. Once this new common platform has been adopted by the distribution industry, we expect to see an increase in the productivity of the entire supply chain.

Once people working in the distribution industry experience the effects of GDS, it is expected that overall supply chain optimization will move forward very quickly. It is also worth mentioning that, in April 2006, the formation of a new company for registering product information and sharing basic information was announced. This is a joint undertaking between Kokubu & Co. Ltd., Ryoshoku Ltd. and Nippon Access, Inc. Even now, it is possible to sense a move towards total optimization.

5 Re-Common Sense Changes Business Practices in Distribution

Thus, we can break through the structural limitations that have been a barrier ever since the era of high economic growth with “the creaking of the supply chain” and move towards a collaborative climate where we all aim to maximize each other’s profits. We have to move away from the hostile relationships between manufacturers, wholesalers and retailers, and instead foster amicable relationships.

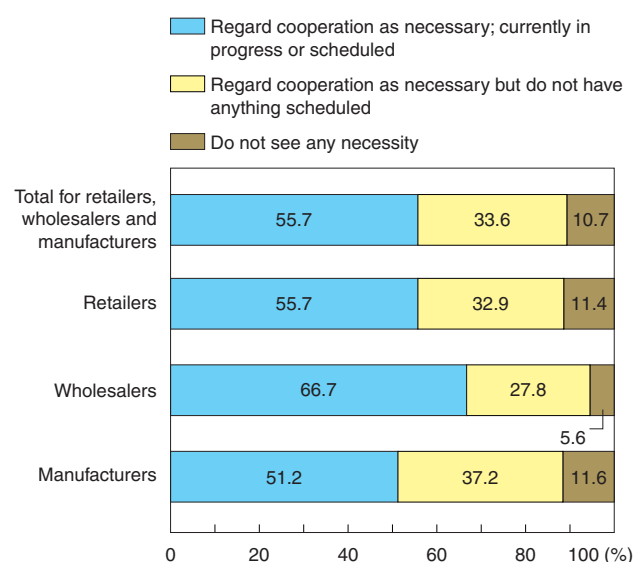
It is actually possible to sense signs of such a shift in the above-mentioned questionnaire survey jointly undertaken by the Japan Retailers Association and NRI. If we look at the distribution industry as a whole, we see that 89.3 percent of respondents see cooperation covering the entire supply chain as being necessary; 55.7 percent already have programs in place or are planning them. In particular, the highest number of respondents taking this point of view (66.7%) can be found among the wholesalers (who have to deal with both manufacturers and retailers) (Figure 5).

In addition, if we look at surveys that have been taken in the US, where collaboration is well advanced, those highly profitable manufacturers and retailers all promote the sharing of information. Considering these facts, we should be able to leverage collaboration in order to optimize the entire supply chain (Figure 6).

With the introduction of open pricing systems and the abolition of rebates, we have reached a point where we can see the beginnings of a change in the relationships between manufacturers, wholesalers and retailers. Such new values seem to be appearing throughout the industry and, by 2010, seem set to become commonly held views by all surviving companies in the distribution industry. The author sees this as a change from the former common sense to the common sense of the new generation, which I call “Re-Common Sense in Distribution.”

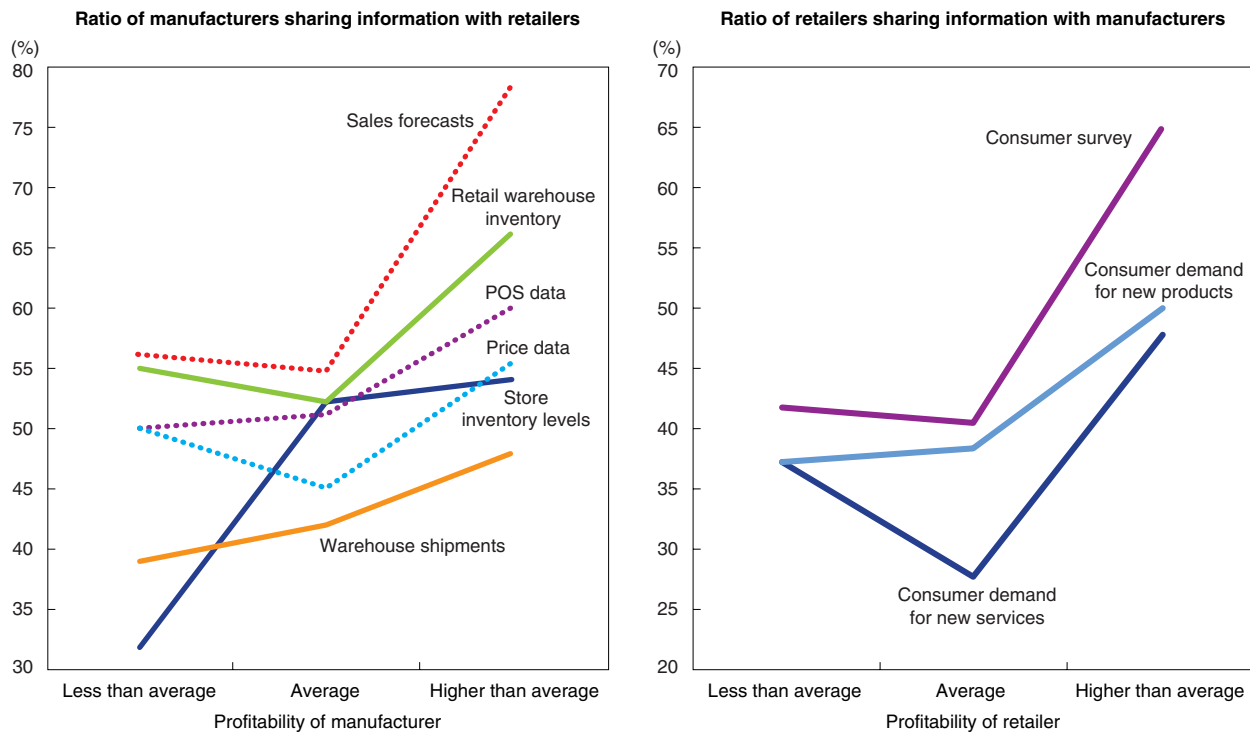
When we consider the situation in 2010, we surely cannot avoid thinking about the business changes described above, with changes even in the structure itself of the distribution industry. Accordingly, to get an idea of how the distribution industry will change in Japan, we must look at how the structural changes have been implemented in Europe and the US.

Figure 5. Current State and Awareness of Companies in the Distribution Industry Regarding Vertical Cooperation



Source: “Questionnaire Survey on the Future of the Distribution Industry in Japan,” a joint survey by Japan Retailers Association and NRI, March 2006.

Figure 6. Extent of Information Sharing between Consumer Goods Manufacturers and Retailers in the US by Profitability



Notes: (1) Survey of the top 100 manufacturers and retailers. (2) POS: Information management at a point of sales.
 Source: Compiled based on "E-Business and Supply Chain Integration," Hau L. Lee and Seungjin Whang (Stanford University), November 2001.

IV Spiral Restructuring in Europe and Heresies in the US

I believe that both Europe and the US have taken basically similar routes. Subsequently, however, several heresies have arisen in the US. These heresies have completely shaken up the US distribution industry and represent a very great difference from the changes that have occurred in Europe.

1 Spiral Restructuring in Europe

If we look at the overall European retail industry, a notable characteristic is that it is becoming dominated more and more by major companies, that is, it is gradually becoming an oligopoly. For example, if we consider the data for the supermarket industry, in most countries the top five companies control more than 60 percent of the market. In France, in particular, this move towards an oligopoly is well advanced, with the largest companies claiming 80 percent of the market.

In 1996, France saw the introduction of the Raffarin Law, which limited the number of branch stores of large-scale commercial entities. This law was quite harsh, targeting sales outlets with floor areas of 300 m² and above. Because of the passing of this law, for three years from 1998, no new hypermarkets were built in France. In addition to preventing the opening of new stores, the Raffarin Law had other effects on the industry. After

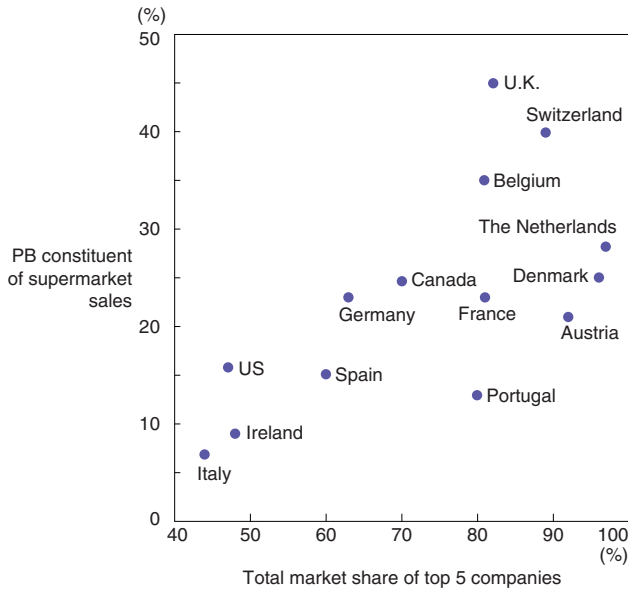
1996, mergers and acquisitions (M&A) of the companies that develop hypermarkets increased. The resulting acceleration of market oligopoly by major companies under such circumstances reminds us of the associated effects of the three town-planning laws in Japan.

Given that it has grown as much as it can in terms of scale, the retail industry has reached a point where it is moving in a direction that will see it improving the quality of its management as a means of continuing to grow. If we look at the relationships between oligopolies and the penetration of private brands (PB) in each of the European countries, we find that there is a definite correlation. Specifically, increases in scale enable us to make PB products more widely available (Figure 7).

Furthermore, while the market will not become an oligopoly overnight, ongoing M&As between individual enterprises will ensure that this situation is eventually realized. When we consider the relationship between the move towards an oligopoly and the penetration of private brands chronologically, we find a very clear correlation (Figure 8). In other words, by expanding the scale of a business through M&As and then using PBs to increase profitability, we can use that extra profitability to finance further M&As to further increase the scale of the enterprise. It is interesting to note that the industry has developed in such a phased format.

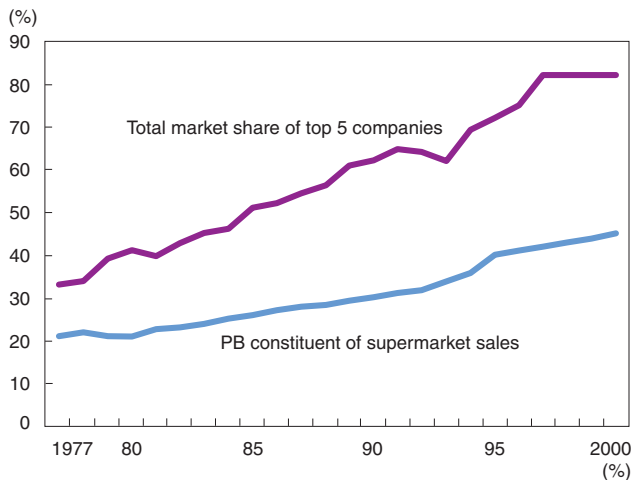
As described above, European business has used M&As, that is, horizontal integration, to increase the scale of enterprises, after which PBs have been used to increase profitability. The manufacture of PB products

Figure 7. Oligopoly of the Market and Relationship to PB Penetration (2000 Survey)



Note: PB = Private Brand (private label)
 Source: Compiled based on "Towards Retail Private Label Success" by Coriolis Research Ltd., February 2002.

Figure 8. Trend in Market Oligopoly and PB Penetration in the U.K.



Source: Compiled based on "Towards Retail Private Label Success" by Coriolis Research Ltd., February 2002.

requires cooperation with the manufacturer through the supply chain. This is called "vertical cooperation."

In addition, if we look at M&A results for the European retail industry, we find that these mergers are not just between retailers (horizontal integration), but around 10—20 percent are between retailers and manufacturers. In other words, the industry is moving more towards vertical integration than towards vertical cooperation. In those countries where retailing is subject to strict restrictions, we see more and more vertical integration. Can we say that retail business, with few other opportunities for growth, has been unwillingly pushed towards vertical integration?

In this way, horizontal integration and vertical cooperation/integration have been alternately advancing. If we think of this spatially, the growth has taken the form of a spiral. Accordingly, we can say that the European retail industry has been exhibiting spiral-type development.

2 US Structure Characterized by Heresy

In the US, also, the industry has been growing through M&As and has taken on a spiral form in the same way as in Europe. Representative US supermarkets such as Kroger, Ahold, Safeway and Albertsons have all grown through repeated M&As. Again, in much the same way as in Europe, PB penetration grew to enhance profitability (Figure 9).

Unlike Europe, however, we find a further step. In 2002, at the peak of the spiral growth, supermarkets saw their profitability suddenly fall. As a result, the No. 2-ranked Albertsons was divided into three parts and taken over by the Cerberus investment fund, CVS drug stores and the SuperValu supermarket chain. Finding itself cornered by the aggressive approaches taken by the largest US retailer, Wal-Mart Stores, Albertsons decided to sell its business.

SuperValu, which was originally a wholesaler, established close relationships with local supermarkets, and opened stores under license agreements. SuperValu's retailing depended on stores that were only 25 percent the size of normal supermarkets, and exploited a niche that Wal-Mart did not address. Therefore, it was easy to presume that the company attempted to grow by taking over a company in a different area.

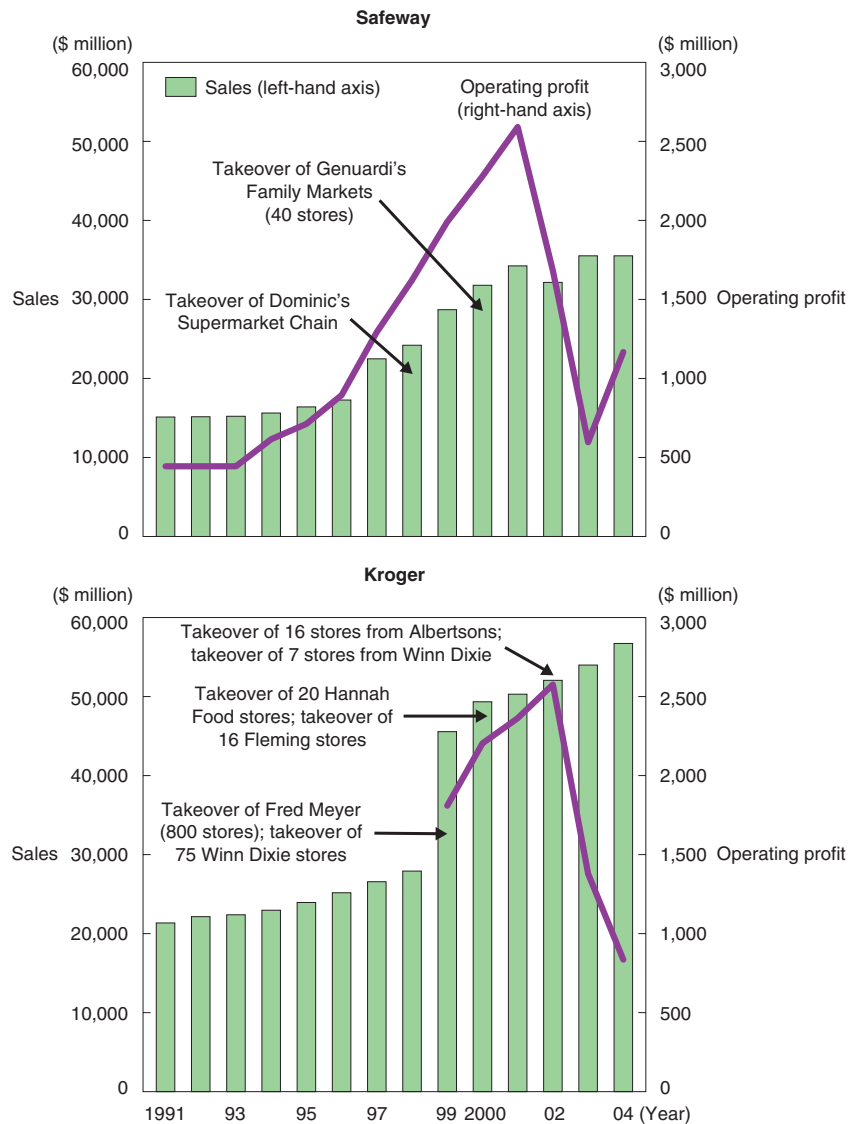
If we examine related events around 2002 in both Europe and America, spiral growth was the norm in retailing, and we could be forgiven for assuming that this was the way of achieving success in the market. However, in America, at least, the spiral growth model of repeated horizontal integration and vertical cooperation/integration was not always the only business model.

3 Spiral Model vs. the Wal-Mart Model

The Wal-Mart business model, which may appear to be superior to the spiral growth model, is the "Collaboration Model" described in Chapter III. By establishing an MD (merchandising) policy through working as one with manufacturers, retailers can expect to achieve greater profitability for both parties, eliminating unnecessary costs in the supply chain, and thus increase profitability through sharing the increased profit among the involved parties. In actuality, Wal-Mart's PB penetration is low and, instead, it offers national brand (NB) products at low prices (Table 1).

Wal-Mart has gained consumer support through its policy of EDLP (Every Day Low Prices). However, consumer support is not the only reason for its policy of EDLP. Rather, one of the principal reasons is to keep prices low to maintain sales levels in its stores. If sales

Figure 9. Trends in Performance of Major American Supermarkets



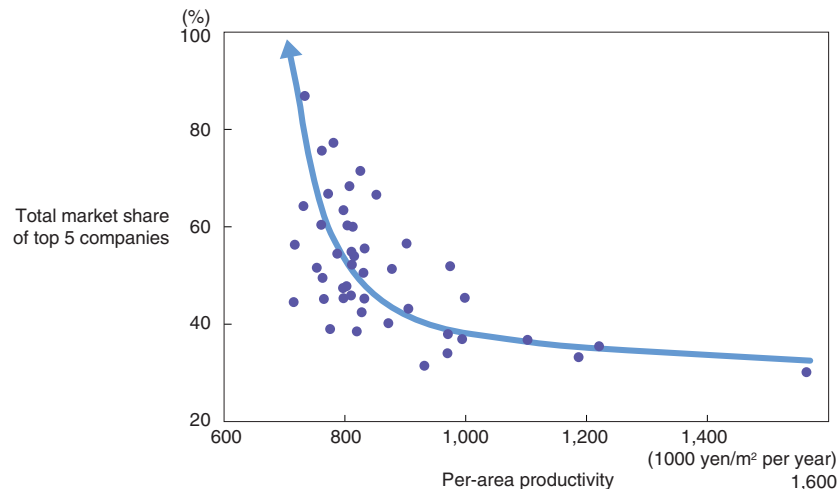
Source: Compiled based on the annual reports of each company.

Table 1. Comparison of National Brand Prices at Wal-Mart Stores and K-Mart

(Unit: \$)

Product	Name	Manufacturer	Wal-Mart	K-Mart
Disposable camera	Fun Saver (27 exposures)	Kodak	4.17	< 6.29
Batteries	Duracell (AA x 8)	Duracell	5.18	< 6.29 (special sale price) < 6.99
Jeans	Relaxed Fit (men's)	Levi's	19.68	< 19.99
Disposable diapers	Pampers (4 to 6 kg size x 112)	P&G	16.67	< 18.89
Shampoo	Pantene Pro-V (750 ml)	P&G	5.68	< 6.29
Mouthwash	Listerine (1l)	Pfizer	5.17	> 4.59
Toothpaste	Crest (175g)	P&G	3.47	> 3.29
Glue	Washable School Glue (225 ml)	Elmer's	1.57	< 1.69
Laundry detergent	Tide (2.95 l)	P&G	7.44	< 7.79
Pet food	Friskies (2.86 kg)	Purina	5.97	< 6.59
OTC pharmaceuticals	Tylenol (40 tablets)	Ortho-McNeil	4.74	< 5.99 < 5.00 (special sale price)
Confectionary	Oreo (510 g)	Yamazaki-Nabisco	2.50	< 3.29 > 2.00 (special sale price)
	Ritz (411 g)	Nabisco	2.27	< 3.29

Notes: (1) Comparison was made in stores in the suburbs of New Brunswick, New Jersey. (2) OTC = Over-the-counter drugs, P&G = Procter and Gamble
Source: NRI store survey (March 2006)

Figure 10. Relationship between Progress of Oligopolies and Per-Area Productivity by Prefecture

Source: Compiled based on Nihon Super Nenkan (Japan Supermarket Yearbook), the Shogyokai Publishing, 2006 and Chiiki Keizai Soran (Data Bank on Local Economies), Toyo Keizai Inc., 2006.

fluctuate, stock levels and labor costs rise at both the retailer and manufacturer, forcing up costs along the entire supply chain. This is called the “Bullwhip effect.” Accordingly, another reason for keeping prices low is to prevent this effect from occurring. This is very different from the business model adopted by Japanese supermarkets that is based on sales at special prices.

It is difficult to say, however, whether the Wal-Mart model is actually superior to the spiral model. In fact, in Japan, Wal-Mart has tried hard to repeat its success with Seiyu Ltd., but the Wal-Mart model has yet to be established in Japan. The Wal-Mart model can succeed only with the cooperation of the entire supply chain. Even the best efforts by only a part of the chain are not enough. Once manufacturers learn to address the needs of retailers and mutual cooperation becomes commonplace, then perhaps the Wal-Mart model can succeed even in Europe and Japan.

V Retailers, Wholesalers, Trading Companies and Funds Are Prime Movers in Restructuring

In view of the status of the Japanese distribution industry and the environmental changes it faces, and while considering actual developments in Europe and America, the following section forecasts how the Japanese distribution industry will change in the future.

1 Acceleration of Oligopoly Through the Expansion of Major Retailers and Horizontal Integration

Cases in Europe and the US show us that when there is little room for growth in the current business territory

and there is no expectation of future growth, a business can grow only by expanding into another territory. That is, expanding into territories by opening new stores, or horizontal expansion through M&As. In Japan, once productivity reaches the stage where it can no longer be improved, the industry will have to search for another solution. Probably, we have already reached that stage. Certainly, we seem to be hearing about more and more alliances being established between regional retailers.

Considering the current situation in Japan as well as in Europe and the US, with major retailers expanding their territories and more and more medium- and small-scale enterprises establishing alliances, we can say that we are well on the way to the establishment of an oligopoly.

In addition, in the same way as in Europe and the US, we see a move towards stressing private brands in Japan, as well as spiral-type restructuring in which horizontal and vertical cooperation is repeated.

At this point, it is worth mentioning that if we examine Japan in cross section, that is, the progress of oligopolies by prefectures, an interesting trend emerges. It seems that oligopolies are more advanced in those areas where per-area productivity is low. This trend probably hints at the direction all of Japan will take in the future (Figure 10).

2 Japanese Factors that Control Restructuring

As we approach 2010, distribution restructuring, as it is called, will result in major changes to Japan’s distribution industry. The form that a country’s distribution industry takes depends to a great deal on its history and current condition. For this reason, it is unlikely that Japan will experience exactly the same kinds of changes that we have seen in Europe and the US. Circumstances that are unique to Japan will result in a uniquely Japanese distribution industry.

While there are many points that could be suggested as being unique to Japan, the following five points would have a major impact on the restructuring of Japan's distribution industry.

- 1) The distribution industry is characterized by a large wholesale presence.
- 2) Trading companies constitute huge distribution concerns.
- 3) Japanese consumers prefer fresh food; providing this leads to a complex distribution structure.
- 4) Japanese consumers are extremely demanding of quality.
- 5) Japan is characterized by residential and shopping areas being near each other, such that many people walk to the store to do their shopping.

Conditions 1 and 2, above, differentiate Japan from Europe and the US in providing an impetus for restructuring of the distribution industry. Medium- and small-scale retailers, in particular, would find it impossible to consider the elimination of wholesalers. At the same time, it is hard to imagine wholesalers standing by as small retailers, who are their customers, are taken over by major national chains.

Trading companies have already moved to establish affiliations with wholesalers and retailers, and a major restructuring of wholesalers has already started, as described above. In addition, trading companies already have established affiliations even with manufacturers. In fact, they have affiliations with every part of the supply chain, both upstream and downstream.

Therefore, distribution restructuring in Japan is expected to depend on horizontal and vertical integration promoted by the wholesalers and trading companies.

Conditions 3 and 4 will also determine the forms of distribution that develop in Japan. Fresh food (vegetables, fruit and fish, in particular) is extremely difficult to store. Therefore, unlike goods such as groceries (food-stuffs other than fresh foods), it is difficult to imagine acquiring these perishables cheaply on the global market. Also, given the Japanese obsession with quality, it is unlikely that they would be accepting of global procurement. Therefore, we cannot expect to create a supply chain that crosses borders in the same way as the Europeans and Americans. Instead, we would strive to establish supply chains based on domestic manufacturers who are aware of and understand the preferences of Japanese consumers.

Condition 5 may seem obvious, but it is perhaps one of the most important factors affecting the Japanese distribution industry. In a mature society, the value of goods is based not just on price, but also on consumer satisfaction and convenience. The Japanese lifestyle is such that, in many areas, we can go shopping either on foot or by bicycle. This is very popular with many consumers. Therefore, in addition to large-scale stores in the sub-

urbs, there are convenient local retail stores, giving consumers a wide range of choices.

As suggested by the example of SuperValu in the US, which is exploiting a niche that is not covered by large stores, large-scale stores would not be the sole choice of consumers. Nevertheless, in the future, being located close to consumers would not promise any benefit. If the prices and quality are not sufficient, no matter how close the stores are, consumers will not come.

Accordingly, there will be a demand for small, yet strong, retailers. The financial industry, in which restructuring is already well advanced, has made much of the concept of the "Super Regional Bank." Similarly, in the retail industry, "Super Regional Retailers," an alliance of small- to medium-sized retailers would be pursued.

By taking the spiral-type restructuring that is commonplace in Europe and the US as a base, and incorporating the Japanese factors described above, we will attain a new distribution structure by 2010.

3 Distribution Restructuring Driven by New Channel Captain

Consequently, what form will the distribution industry take in 2010? Taking into account what we have considered so far, the following scenario could be possible.

The player who has the most significant role in the supply chain regarding the setting of price and transaction conditions is called the channel captain. Before World War II, this player was the wholesaler and, subsequently, the manufacturer. Only recently, have retailers become channel captains.

In much the same way, with the restructuring of the distribution industry, it is thought that the enterprise with the kind of presence described below will act as the channel captain.

A channel captain varies depending on the source of its presence. It is considered that a new distribution setup will be formed with each new channel captain.

(1) Major retailer with massive purchasing power acting as channel captain

A major retailer, given its massive purchasing power, will continue to become the channel captain. They will take the initiative to promote horizontal integration so as to create mega-chains with high productivity. In a way similar to what we see in Europe, they are also likely to plan vertical cooperation in order to improve PB penetration.

Moreover, we can assume that the large-scale retailers as channel captains will take the initiative to promote optimization of the entire supply chain. In addition to collaboration with the manufacturers and wholesalers, we will also see relationships based on vertical integration in pursuit of affiliations involving capital investments.

(2) Wholesaler, trading company or voluntary chain with excellent networking acting as channel captain

Wholesalers that have traditionally been large, as well as those that have grown through forming alliances, can leverage their networking capabilities to enhance their presence, making them a channel captain. The positioning of voluntary chains (formed by multiple independent retailers who share the costs of stocking, advertising, delivery, etc.) is also changing, with greater importance being given to each of the retailers forming the chain. The significance of the existence of an intermediate distribution network will increase, which will form the power necessary to compete with the mega-chains described in (1), above.

These intermediate distribution enterprises, when acting as the channel captain, in cooperation with the retail chains, enable the optimization of the entire supply chain. While dealing with multiple retail chains on an equal footing, they will give rise to a distribution structure that facilitates the generation of a reasonable profit.

(3) General trading firm or investment fund company with large financial resources acting as channel captain

General trading firms and the investment fund companies, which have not played the role of channel captain in the past, can do so by using their financial power to deepen their relationships with the distribution sector. To enable themselves to compete with the move towards mega-chains in the retail industry, they may enhance their relationships with small- to medium-sized retailers that lack funds and sufficient scale. They may possibly aim to form a new, third style of retail chain.

We assume that it may be the channel captains with financial power that will provide the base for super regional retailers that carefully deal with the needs of consumers in small business territories with their unique strength.

VI What Must the Distribution Industry Achieve as We Approach 2010?

As already described in this paper, 2010 will see the distribution industry passing the phase of horizontal inte-

gration, and it will see an era of vertical cooperation and integration. Distribution structures vary according to the types of business and business conditions, as does the channel captain who drives restructuring. Generally speaking, however, once horizontal integration has led to the creation of an oligopoly, it is important for a company to decide on the position that it should take in the market. A company should decide whether it wants to be the channel captain or enter into an alliance with the channel captain. In the latter case, which company will act as channel captain will have to be acknowledged and preparations should be made from an early stage.

Furthermore, to enable dealing with the flow of vertical cooperation/integration successfully, it will also be necessary to establish an IT platform and scientific transaction mechanisms based on the visualization and sharing of costs. In addition, the establishment of a demand chain (flow of products and services based on consumer information) that also covers manufacturing would be called for.

Furthermore, with respect to the progress of vertical integration, it may be concluded that line division for each product and/or service will achieve greater efficiency rather than functional division for each supply chain step (every step from product planning to sales) as implemented in the past. It is also conceivable that the organizational structure and management systems will be changed from the functional division of the past to separation by product category. Such differentiation may further involve companies separated by pseudo categories. In this case, we will have to move away from the comprehensive management of the past and instead adopt a mechanism of new governance to manage individual players.

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Noriaki HINO is a group manager at the NRI Service Business Consulting Department. His specialties include business strategies, business reforms and system strategies in the distribution field.

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Inquiries to: Corporate Communications Department
Nomura Research Institute, Ltd.
E-mail: nri-papers@nri.co.jp
FAX: +81-3-5533-3230