

# 5 Distribution Channels in China

## 5.1 INTRODUCTION TO MARKETING CHANNELS

As more and more foreign products and factories enter China, and the more developed their denim industry becomes, the environment (domestic and international) in which denim businesses operate has become intensely competitive. This competition is creating fierce battles for market shares, and the distribution channel is an important factor in this competition.

### 5.1.1 The definition of a marketing channel and its tasks

The American Marketing Association defines *channel of distribution* as "an organized network of agencies and institutions which, in combination, perform all the activities required to link producers with users to accomplish the marketing task." [1]. Distribution is the physical flow of goods through channels; as suggested by the definition, channels are composed of a coordinated group of individuals or firms that perform functions adding utility to products or services [2].

It is not always a practicable solution that the producer delivers directly to the consumer or the consumer collects directly from the producer. Intermediate agents pass the products along to the consumers. Distribution channels, as the intermediate between producer and consumer, perform specific functions that the manufacturer cannot or prefers not to do.

As we have seen, a channel of distribution is a group of individuals and organizations that direct the flow of products from the point of their production to the consumers. [3]. The consumer is the ultimate driver of all channel activities. Marketing channels provide utilities for customers that could be a basic source of competitive advantage and product value. The major categories of channel utility are *place* (the availability of a product or service in a location that is convenient to a potential customer); *time* (the availability of a product or service when desired by a customer); *form* (the product is processed, prepared, and ready to use and in proper

condition); and *information* (answers to questions and general communications about useful product features and what benefits are available) [2].

There are two essential parts of the concept of a marketing channel. One is moving a product from the manufacturer to the consumer or user; this is called a physical distribution structure. Another is established as a part of the channel of distribution to assure the manufacturer that all marketing objectives are accomplished. a marketing structure [4].

The tasks to be accomplished in the marketing channel may be described by four actions [4]:

#### 1. Communication

Communication includes all forms of communication in marketing, covering advertising, literature, product promotions, mail, telephone, training, and any contact related to marketing information. Communications must be timely and accurate to be effective in serving the marketing channel. In addition, the channel communications are a two-way system, with information flowing from the manufacturer to the consumer and feedback from the user to the producer.

#### 2. Selling

The selling task is the act of transferring title to the product from one channel member to another.

#### 3. Shipping and storing

The capabilities of receiving, storing, and shipping products may be a requisite on for some channel members. However, this function of physical distribution may also be performed by facilitating agencies, such as public warehouses and common freight carriers, at one or more levels in the channel of distribution.

#### 4. Providing product and customer services

Customer services include those tasks needed to inform, train, fulfil legal and regulatory requirements, and provide facilitating services such as credit extension.

These tasks of communicating, selling, shipping, storing, and providing customer services are usually carried out by the members of the marketing channel. However, some of the tasks are facilitated by companies that are not direct channel members but nonetheless have a part to play in providing special services that make the actions effective or efficient. These include facilitating agencies such as banks, truckers, advertising agencies, market research agencies, and the like.

### **5.1.2 Distribution channel participants**

The participants are all members of the marketing channel and are either merchants or agents. Merchant participants are manufacturers, marketers, wholesalers, jobbers, distributors, retailers, branch operators, users, consumers, and any other term that applies to the industry involved. Brokers, manufacturer's representatives, and commission agents are the three kinds of agent members. Agencies/facilitators that indirectly facilitate the tasks of the marketing channel such as banks, advertising agencies, sales promotion firms, transportation companies, public warehousing and

storage companies, insurance companies, and marketing or market research companies are also added into the distribution channel.

With the approach of new technology, the membership of distribution channels has developed. The traditional direct participants such as wholesalers, jobbers, retailers, etc, still play an important role in commodity goods distribution, but have now been joined, for example, by the Internet.

Wholesalers distribute goods in large quantities, usually to retailers, for resale. Wholesalers are an extension of the producer's sales force, performing specialized stock accumulation and distributor allocation functions, allowing producers to concentrate on producing and developing goods, and assisting retailers by holding stock until needed, thereby reducing the retailer's need for storage [3].

Retail includes all transactions in which the buyer intends to consume the product through personal, family or household use. A retailer is a business that purchases products for the purpose of reselling them to the ultimate consumer, and normally provides an assortment of competing products to meet consumer demand. Because retailers have direct and, in many cases, personal contact with the customers, they are able to feed back accurate information to the producer about the market. The types of retailers include department stores, supermarkets, chain stores, discount stores, speciality shops, convenience stores, factory outlets, warehouse clubs, superstores, catalogue showrooms, and non-store retailing.

During the twentieth century, more manufacturers have joined in goods distribution themselves in order to shorten the distance between the manufacturer and consumer. The success of distribution channels such as direct selling, direct marketing, and the Internet testify to this.

Direct selling delivers goods from producer to consumer directly through one-to-one selling. Later, as a development from one-to-one selling, the party plan appeared, in which a "host" invites friends to come and see a range of goods for sale. In that way, consumer resistance is reduced and peer pressure is used to make the sale. Another kind of direct selling, multilevel marketing, is when a company recruits individual business people to act as distributors for the product. Those people will, in turn, recruit sub-distributors who, in turn, recruit still more.

Direct marketing includes marketing by catalogue, television shopping, telephone marketing, and vending machines. Direct marketing is sidestepping traditional retail stores and dealing directly with customers, cutting the time and cost of transactions. In 1986, French enterprises began to dispense Levi's 501 jeans in France, and later expanded into Canada, Britain and Spain. The price of jeans sold in vending machines was cheaper than the jeans in department stores, as it didn't need a person to operate it. This approach was quite successful at that time [5].

The Internet has been a hot topic from the 1990s, since it brought a new type of distribution channel--e-commerce. A combination of computer and communication technology, the Internet developed rapidly in the 1990s, and became one of the newest and best business communication channels. It is fast, reasonably reliable, inexpensive, and universally accessible, and serves a huge and growing consumer group. Doing business online is regarded as a new direct channel to the consumer. Worldwide famous brand denim apparel, such as Levi's, VF, Guess, etc, successively set up a shopping window on the web in 1998, after introducing their Internet Web to consumers. In this way, buyers can shop not only in stores, but also at home, or any place where the Internet has arrived. Online shopping also can help producers to reach the right customer more frequently, communicate with the consumer more easily,

provide the best and most appropriate products, and strengthen customer relationships, thus improving loyalty.

The channel numbers deliver not only goods and information between producer and consumer, but also create value (service) for the consumer. The manufacturer gives up some control over the products and markets involved, paying a part of the profits for these services.

## **5.2 DISTRIBUTION CHANNELS IN CHINA**

### **5.2.1 China's distribution system and its reform**

The reform of China's distribution channels was launched as soon as the country began its economic reforms. During the past two decades, the steps of restructuring, consolidation, and rectification had been carried out. Sherriff T.K. Luk [6], investigated the period from 1978 to 1995, and studied the structural changes in China's distribution system, which stemmed from the elaborate procedure of distribution channel reform.

Before China economic reform, the Chinese economy was under a central planning system. The Chinese government adopted a central, three-tier distribution system, including Grade I Wholesale Stations (State level), Grade II Wholesale Stations (Province Level), Grade III Wholesale Stations (District Level), and Grade IV wholesale Stations (City/Country/Township), to control the flows of commodities. Within this system, the first-level (State Level) wholesalers acted as general control agents responsible for primary national or regional distribution. The second-level (Province Level) wholesalers were in turn responsible for provincial or major urban distribution. Finally, the third-level (District Level) distributors administered local distribution centers and dispatched goods to retailers within their areas. The three-tier distribution system was operated by a top-down approach in the allocation of production and distribution quotas according to the central government's mandatory plan. Local state-owned wholesalers served as intermediaries between the producers and the retail outlets and were required to store products and transport them to local retailers. Under the central planning distribution system, market forces were restrained and suppressed and distribution activities were monopolized by state-owned commercial units in city districts and co-operatives in the countryside, resulting in a highly rigid, inefficient distribution network spreading its links to both wholesale and retail areas.

After 1978, reforms were launched in phases. The first was from 1978 to 1985, when the Chinese government extended autonomic power to enterprises: financial power, planning and operational power, the power to fix and regulate the prices of some commodities, personnel management power, and established democratic rights of the workers and staff in 1984. In addition, enterprises were allowed to sell not only those products produced on their own initiative but also products in excess of the sales quota imposed by the government. Thus, both manufacturers and commercial enterprise would have a greater degree of autonomy to explore new markets and to select their customers and middlemen. The second period was between 1986 and 1988, when the government focused on developing horizontal links between enterprises across different industries and/or provinces to promote and distribute the products to different regional markets and to sweep out bureaucratic and geographic barriers. In the third phase, from 1989 to 1991, the major project was to rectify the

loopholes that emerged in tandem with the distribution reform, which were caused by the lack of relevant experience and a well-developed legal system. In the fourth phase, from 1992 to the present the sturdy determination of the government is to create a market economy, further reforms have been launched. The government has allowed more commercial enterprises and large manufacturers greater autonomy to import and export goods and components. Meanwhile, several ministerial systems within the distribution sector have been re-organized with the primary objective of improving the administrative efficiency of governmental organizations, improving the internal management mechanisms of commercial enterprises, avoiding the duplication of resources and functions in various governmental departments, and, ultimately, of facilitating the cultivation of a more market-oriented system. The re-organization took place both at the state level and at the local level. At the state level, various administrative departments within the old Ministry of Commerce were transferred to specialized corporations to improve operational efficiency, and the former Ministry of Commerce and the Ministry of Materials and Equipment were merged to form the new Ministry of Commerce of Domestic Trade. At the local level, re-organized government bureaus were implemented on an experimental basis in a few sample provinces/cities.

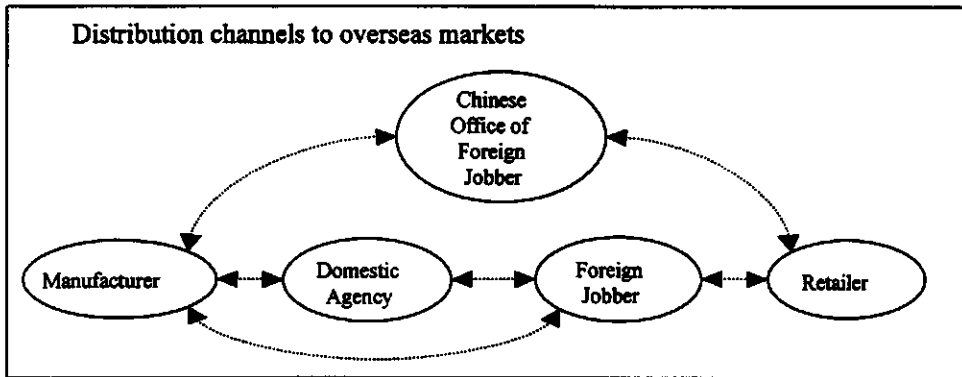
With the phased reforms, the Chinese distribution system was changed from being selling-oriented to being market-oriented. The retail sector was reformed from the traditional supply-driven system to an increasingly demand-driven one. It was composed of department stores, retail shops and groceries, supermarkets, free market, collective owned distribution networks etc. The wholesale sector, following the retail sector, reformed to become market-oriented through reducing the level of control, constructing regional wholesale markets in urban and rural areas throughout China, building and operating state-level wholesale markets on a market-oriented concept, and improving the competitiveness of state-owned wholesale enterprises. The new distribution channels, not only provide "time" and "place" utilities, they now perform value-added and differentiated marketing activities.

### **5.2.2 Current Chinese denim products distribution channels**

Chinese textile product distribution has undergone every phase of the distribution system reform, and changed from a central planning system to a market-oriented one. Denim products are a newcomer in the textile sector, and its current distribution channels will be discussed in the following sections.

#### *Distribution channels to overseas markets*

Figure 5.1 shows the distribution channels for Chinese denim products to overseas markets [7]. There are three main patterns of distribution channel for China denim apparel. Pattern A consists of the denim manufacturer, a domestic agency, a foreign jobber and a retailer. In pattern B denim apparel was distributed from the manufacturer to a foreign jobber directly and then to a foreign retailer. The last pattern was that in which manufacturers sold products to the Chinese office of foreign jobber, then to a foreign retailer. Among these, pattern A is applied most widely in China.



5.1 Distribution channels to overseas markets

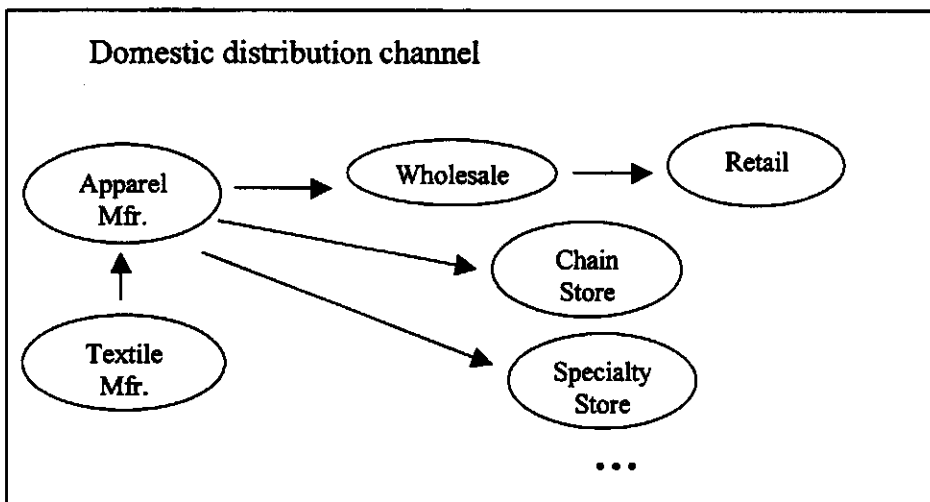
*Distribution channels in domestic markets*

A survey [8] has been carried out on the distribution channels in China of 77 manufacturers, which are located in 14 provinces, 28 in Guangdong, 10 in Fujian, 9 in Jiangsu, 8 in Shandong, 5 each in Zhejiang and Shanghai, 3 in Jiangxi and Henan, and 1 in each of Beijing, Hebei, Shaanxi, Guangxi, Liaoning and Jilin. Among the 77 manufacturers, 5 enterprises owned specialty stores, and 9 owned chain stores.

The main distribution channels for denim products in the Chinese domestic market are shown in Figure 5.2 [7]. Again, there are three major distribution channels. Pattern A is that in which manufacturer sell their products to wholesalers, then to retailers, was the most important distribution pattern in China domestic market. In pattern B manufacturers sell their products directly to retailers.

Currently, in the Chinese apparel market, private retailers, supported by huge wholesale markets, play an important role in China apparel market. This pattern is accepted widely in China, particularly in the rural market and part of the urban low-grade products market.

Department stores were the major distribution channels for high-grade garments, such as imports and some domestic brand denim apparel. The sale strategy of Chinese department stores was to operate on a commission basis. This didn't benefit the monies flowing to the apparel manufacturers, and the department stores are facing a strong challenge from new style distribution channels.



5.2 Domestic distribution channel

Speciality stores are a new, quickly developing outlet in China. They offer competitiveness in ensuring a brand image and a fast cash return. Hyper markets, Super markets, and Chain stores are the fastest developing distribution channels, having low operating costs and competitiveness on low prices. They are seen to advantage in jeans, underwear, shirts etc. not in fashion items. They are usually large scale, sale at low prices and are welcomed by consumers.

In our investigation, we found that most of the China denim apparel is distributed in domestic market was by pattern A, involving wholesalers, and retailers. New style outlets, such as specialty stores and chain stores sold about 5.0 per cent of manufacturers' products.

#### *Channels of foreign products access to China market*

According to statistics released four years ago, there were barely 300 jointly-funded (Sino-foreign) retail companies in China, but more than 313,000 domestically-funded retail companies. Foreign-funded retail companies do not even make up 0.1 per cent of the total. The number of their sales locations is even smaller when compared to those of domestically-funded retail companies, making up only 0.003 per cent of the total [9]. The domestic retail sector does not really face direct competition from its foreign competitors in the Chinese domestic market.

Foreign goods gain access to the Chinese market through many kinds of channels. The first is through foreign retail joint ventures, who were allowed to operate retail businesses on a limited experimental base from 1991, but whose imports must not exceed 30 per cent of their total sales. The other channels are through agencies of national or regional Import & Export companies, and larger enterprises who own licenses to operate an import/export business. These channels shared a big part of the distribution of foreign goods in China. Exhibitions and Fairs provide opportunities for finding agencies for foreign goods.

#### **5.2.3 Retail of denim apparel**

Denim apparel was introduced into China in the 1980s and was considered a young and fashionable product. Denim apparel has now become a major category in the China clothing market, since Chinese consumers have found them to be natural, unrestrained and durable.

In 1997 the China Statistical Bureau surveyed denim apparel sales in 112 important department stores in China and found that more than one million units of denim apparel were sold, which accounted for more than 1 per cent of the total Chinese domestic denim apparel sales. Eighteen brands of denim apparel accounted for more than 75 per cent of the total denim apparel sales in the surveyed department stores. Among the eighteen brands, Boton had the biggest market share of 17.4 per cent of total department stores sales, the second most important brand was Weipeng with a share of 15.6 per cent, followed by FUN and Jianlong, with 5.8 per cent and 5.1 per cent of market share respectively. The other 14 brands of denim apparel such as Popo, Qipanwang, Dali, Red Taps, Guoshu, Apple, Nanfang, Lanyi, Gaorpu, Billy, Yiren, Mingshi, Lanlinton, and Aochai, shared the 31.6 per cent of market share.

Denim apparel is sold not only in department stores, but also in special stores and free markets. Branded denim apparel products are usually sold in such place. Non-

branded denim apparel is usually sold in street markets and wholesale markets with lower prices.

### 5.3 DEVELOPMENT AND MANAGEMENT IMPLICATIONS

In the past, foreign retail business was forbidden, and retail joint ventures were only allowed in 11 cities including Beijing, Shanghai, Guangzhou etc. in 1992. In June 1999, China's State Economic and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation promulgated new rules that would relax restrictions on Sino-foreign joint ventures in the retail and wholesale sectors. According to the new rule, retail joint ventures in China may now open businesses in any of China's provincial capitals and autonomous regions as well as in other major cities. Wholesale joint ventures will also be allowed, but for new only in Beijing, Tianjin, Shanghai, and Chongqing for new ones. However, foreign investors are still not permitted to maintain one hundred per cent ownership of wholesale and retail companies in China for the time being [10].

Under the new rules, multinationals who have multiple manufacturing plants in China will benefit the most as they will be able to consolidate their sales force and have a more direct relationship with retailers. Meanwhile, the rule also helps importers, who under current restrictions are required to pass their goods through licensed domestic importers and wholesalers [10].

To protect domestic industries, currently foreign firms in China may not distribute products other than those they make in China, and they may not own or manage distribution networks, wholesale outlets or warehouses. Such restrictions may lessen as required by other WTO members because China is applying to be WTO member [10].

If in the near future China enters the WTO, China would open its market more and more, and foreign leading brand denim jeans manufacturers may enlarge their market share in China via: 1) share more of the China domestic market by lower cost products made in China; 2) establish own international retail network.

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