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Rethinking Consumer Product Distribution in Developing Countries

The methods of getting products to market in India and other developing countries are neither the best nor most lucrative ways to deliver the goods. These days, direct coverage is better than indirect.

For consumer products companies in India, getting products to retail locations faster and more cost effectively than competitors is key to top-line growth and competitive advantage. Yet India, like many other developing countries, has yet to update its distribution models to keep up with today's competitive, connected markets. The cost of distribution can run as high as 18 to 25 percent of sales (for example, on channel margins and trade management), making it the second-largest line item after raw materials. Around the world, as soaring costs put pressure on margins, and channel partners want better returns and faster growth, rethinking distribution could well be the ticket to improved sales and top-line growth.

Win-Win-Win Distribution

Every partner in the retail distribution channel—from manufacturer to distributor to retailer—has expectations about returns on investment. And while many players may hesitate to make a change from a legacy distribution model for fear of compromising the needs of other stakeholders, it is time to put those worries aside and develop a "win-win-win" distribution model. The right model will not only work for India markets but also for other developing countries with unorganized retail penetration.

When success depends on making products more attractive and visible than the competition, **it's time to consider direct retail coverage as a way to improve top-line growth**.

Developing a new retail distribution model requires taking a closer look at three dimensions: coverage of retail outlets by channel partners (direct versus indirect), channel productivity (more sales, lower costs), and the payout (total retail expenditures). In this paper, we focus on the first dimension: direct versus indirect coverage.

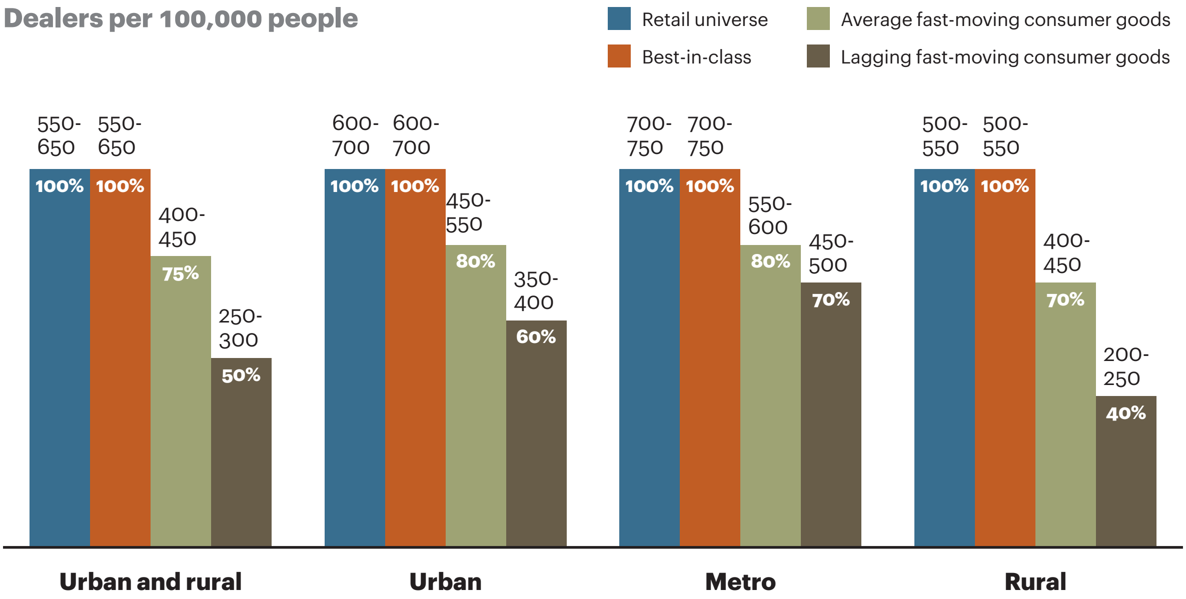
Why Increase Direct Coverage

Distribution models have been evolving over the past several years. The last wave of change involved consolidating with fewer, bigger, and better channel partners while simultaneously rationalizing, using channel partners to get rid of slow-moving items. This led to less direct coverage. As a result, today there is legitimate skepticism in the sales and distribution fraternity about increasing direct coverage. Indian organizations are behind in terms of direct coverage when compared to retailers around the world (see figure 1 on page 3).

Yet, today, when success depends largely on making products more visible than the competition, and using visual merchandising and point-of-sale strategies to communicate a product's value, we believe now is an opportune time to take another look at direct retail coverage as a means to improve top-line growth. There are five reasons why:

Figure 1

Compared to best-in-class, many food companies in India lag in terms of direct coverage



Source: A.T. Kearney analysis

Urbanization. Swelling urbanization and population density in India means previously marginal retailers are now more significant in billing size.

Emerging channels. The convergence of retail channels—drugstores selling personal care products and grocers selling healthcare products—creates opportunities to add meaningful new retailers to distribution routes.

Ambitious distributors. Distributors today aspire to make at least INR 1 to 1.2 million per year (US$16,000 to $19,000), which requires sales of INR 4 to 5 crores (US$656,000 to $820,000). Covering more outlets makes these targets easier to achieve.

Improved range. Unlike indirect distribution where the wholesaler's focus is largely on fast-moving, high-volume lines, direct coverage of retail outlets allows for preferred, more effective placement of new products and variants, which can be key to sales performance.

Visual merchandising. Stiff competition requires bringing products to life at retail outlets and making an emotional connection with consumers. Direct reach provides an opportunity to use visual merchandising techniques to make these "moment of truth" connections and win the sale.

When to Expand Direct Coverage

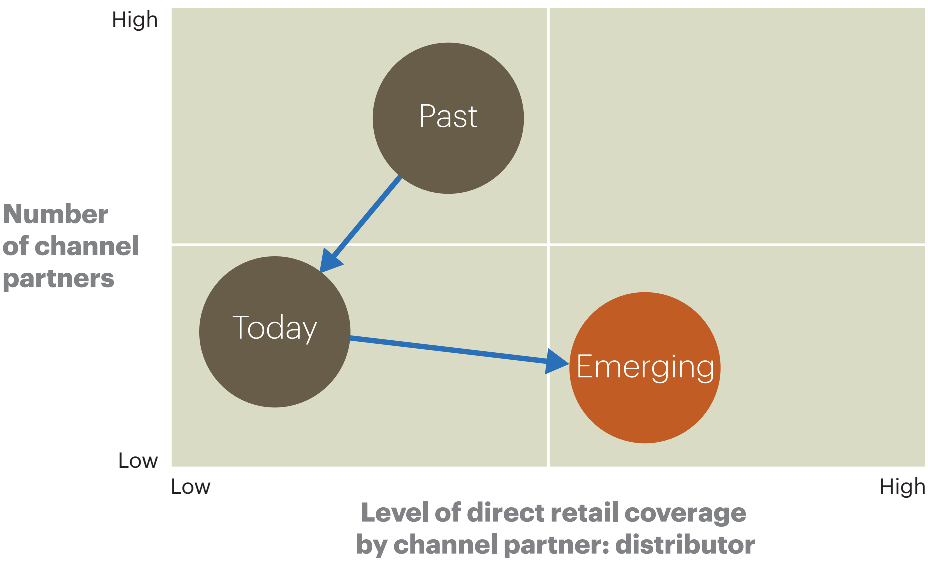
One fear when expanding to direct coverage is higher service costs for distributors, but we consistently see a substantial number of new retailers with a bill size that more than pays for the added costs. Another common fear is the potential cannibalization of wholesaler sales, but the improved range for selling can more than compensate for any potential dips in whole-saler billing.

If any of the following criteria apply to your situation, direct coverage could be a viable strategy:

- Product portfolio that spans multiple categories
- More than 20 percent of sales from new products
- Last distribution overhaul was more than two years ago
- A distribution model with a large number of small distributors
- Several large shops in a beat are missed

An important difference in the emerging distribution model compared to the ones familiar to Indian organizations is more direct coverage served by fewer and bigger distributors (see figure 2). Keeping control of the number of distributors ensures that manufacturers' distribution costs do not increase (because of higher transportation costs) while simultaneously improving distributors' top lines to better absorb fixed costs.

Figure 2
The new retail distribution model uses more direct coverage and fewer distributors



Source: A.T. Kearney analysis

Six Ways to Cover More Outlets

Expanding outlet coverage by channel partner is not a simple activity. It requires balancing the trade-offs between higher distribution costs and the additional gains from increased sales, and ensuring that the new outlets are able to carry a wider range of products to compensate for potential cannibalization of wholesaler sales. Also, during the expansion process, the sales force and distributors must maintain business as usual even while there is a tendency to resist change.

For those who get it right, the payoff can be substantial. With a comprehensive process that generates value for all stakeholders, it is possible to increase sales anywhere from 3 to 5 percent. We recommend a six-pronged process, what we call the 6Ps, shown in figure 3 on page 5:

Figure 3
The six "Ps" help companies expand direct coverage

Source: A.T. Kearney analysis

Build credibility with a pilot program. Because every organization is unique, expanding direct coverage requires a tailored approach. Refining the new model in two to three cities before a wider rollout establishes proof of concept and addresses unique pain points in the early stages. A successful pilot can convince the sales force about the project's feasibility.

Use third-party prospectors to find new outlets. For a typical distributor covering a radius of 5 to 10 kilometers in urban areas, identifying uncovered outlets is a three- to four-week exercise. Although this can be performed by the distributor's sales force, using third-party support for "outlet prospecting" prevents disruptions to sales schedules and gives focused, unbiased attention to the task. Third-party prospecting activities are best guided by the company sales officers who need to ensure that the new outlets are operational (by the first bill generation) before the sales force takes over.

Create a profile with a rule of thumb for identifying new outlets. Outlets to be added to direct coverage should be able to order above a certain threshold (to be estimated as total category stocked times company market share in the region). This threshold varies by industry, but we have seen that any outlet with the potential to purchase more than INR 1500 per month and within five kilometers of the distribution point can be profitably served. Outlets below this threshold are typically unprofitable and are better served through the wholesale channel or through ready stock delivery in kiosks, especially if there is a high density of low turnover outlets in the distributor's trading area. A focused expansion drive can help identify as much as 70 to 80 percent more retail outlets.

Partner with a distributor to serve new outlets. Identifying new outlets is only half the battle. Getting the distributor to serve the new outlets is the other half. Regularly communicating the benefits in terms of the impact on business turnover, profits, and return on investment is essential to winning them over. Orchestrating several activities with the distributor will help ensure that new outlets are added successfully. And remapping the sales and delivery beats is essential. Remapping, ideally done jointly by the area sales manager and each distributor, should guarantee that newly carved-out beats are economically viable. In addition to new beat schedules, communications training for the sales force should focus on the value proposition for new retailers. Mobilizing the distributor to scale up resources in terms of both sales force and infrastructure (vehicles and selling resources such as handhelds) is also important. The ideal sales and delivery beat plan minimizes the need for additional distributor investments.

Monitor performance to sustain growth. A company typically does a good job ensuring the "first bill cut" at new outlets, but over time, inconsistent service levels and irregular sales visits lead to declining performance in these outlets. Regular monitoring of outlets during the gestation phase coupled with providing retailer incentives (where applicable) can sustain new retailers in the long run. Although the first bill gets cut within the first month of operation, reaching a steady state can take another three to four months. During the stabilization phase, it is important to track progress with key outlet performance metrics and to quickly address any issues.

Plan centrally, execute locally. Designing the blueprint for expanding coverage is best done centrally. This way, a think tank can assess the market potential in each business region and craft a suitable coverage expansion approach, implementation road map, and key metrics for scale-up. However, on-the-ground execution—including outlet identification and operationalization activities—is best run locally under the supervision of area sales managers and company sales officers. A full-scale implementation across a country like India can take nine months to a year, depending on the resources deployed. To expedite the process for quicker returns, it is wise to deploy a full-time team.

The Ticket to Growth

In India and in other developing markets with unorganized retail markets, expanding direct coverage can be the ticket to significant top-line growth. And it can help channel partners realize that it is possible to improve on growth by means other than raising margins. Forward-thinking companies that use direct coverage to keep their products visible in today's highly competitive market will rapidly see improved sales and a solid foundation for long-term growth.

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