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Distribution Challenges in the Chinese Economy Focusing on Finance

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Abstract: The purpose of this paper is to analyze the advantages and disadvantages of different distribution methods available to Beijing Oasis and decide which method should be implemented. Based on the advantages and disadvantages of each distribution method, a recommendation will be offered as well as implementation of that decision.

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Statement of the Problem

The most vital issue currently facing Gervais Lavoie is the decision of method of distribution. He has been given three alternatives with which to analyze. Poor distribution decisions in the past have caused businesses to fail dramatically, so he is imminently aware of the magnitude of this decision. What method of distribution should be implemented for Beijing Oasis High Nutrition Food Company Ltd. to distribute the company's newly developed fruit nectar? This is a problem because, as stated before, the consequences of a poor distribution decision could prove fatal.

Situation

Through steps to open its markets to international exporters, and to comply with World Trade Organization (WTO) membership application requirements, global trade with China has changed significantly in recent years. "After a decade of reform, the economic situation in China has improved enormously. " Opportunities are available to foreign companies to enter the Chinese fruit juice market, with tax and land incentives offered to lure foreign business to China's special economic zones, and tariffs lowered to invite imports . "The adaptive ability is shown in learning new concepts and rules developed in a market economy, which might involve changing assumptions and the way of thinking."

The fruit juice market in China is dynamic, with many opportunities for international competitors to enter the sector. In 1995, Canada held 1.6% of the $63.9 million imported fruit juice market in mainland China, but that share slipped to 1.0% in 1996, despite the fact that the value of the market increased to $69.4 million. Imports of fruit juice to Hong Kong decreased to $119.1 million in 1998 from a high of $186.7 million in 1997. Canada supplied 5.4% of Hong Kong juice imports in 1998, and could dramatically improve upon its share of China's total fruit juice market . "…There is a valid argument that emphasizes concentrating resources in enterprises that are less state-controlled on the grounds that they are more efficient. The Chinese experience according to some economists tends to support policies emphasizing small and mid-sized enterprises of all kinds because they can avoid the institutionalized sclerosis of the industrial giants of past years, more rapidly reap greater economies of scale, and so on. " Given recent trends towards healthier lifestyles among younger Chinese consumers, the nutritional advantages of fruit juice are expected to spur significant growth in the sector, providing good opportunities for Canadian exporters. Stronger promotion of the freshness, taste, variety of flavors, and nutritional benefits of juices will help increase sales and gain market share. Exporters should note that as the market continues to expand, several international competitors are establishing a greater presence in China. The most notable international competitors are from the United States, Australia, South Africa, Brazil and Singapore.

Boasting a population of more than 1.2 billion, China's place as the world's most populated nation is driving interest among companies from around the globe. However, due to the socialist economic principles traditionally practiced by the Chinese government, China remains a relatively new market for international exporters looking to explore opportunities in foreign markets. Basil G. Englis, author of "Global and Multinational Advertising," says, "Western advertising agencies and multinational corporations that are planning on entering the Chinese market need to be fully aware of the unique traits of the Chinese economy. Understood properly, these traits can turn into marketing opportunities. If misunderstood, these very same traits can turn into fatal obstacles to competing in the Chinese market. " Englis continues by offering these traits:

China's trade/GDP ratio is one of the lowest in the world

•Imports increase at a phenomenal rate, ranging about 35% per year

•47% of China's GDP is from industry. Other developed nations average about 33% per year.

•There is an abundance (almost limitless) of cheap labor as well as low production costs.

•City dwellers earn three times more income than people living in the countryside.

Chinese markets are opening more to foreign suppliers, however the government still retains some control through import quotas, customs restrictions, and various centrally planned economic policies.

China's economy is doubling every eight years, and its GDP quadrupled between 1980 and 1995. Real GDP growth reached 9.7% in 1996, slowing to 8.8% in 1997. Although official estimates put 1998 GDP growth at 8%, it is more likely that growth will slow to 7%. China is increasingly active in the world economy, ranking as the world's 11th largest trading nation before the Hong Kong reunification. The nation accounts for 2% of world trade, and foreign trade accounts for 35% of its GNP.

Alternatives

Alternative #1

Distribute by means of State-owned Distributors.

Advantages:

•Favored by firms with limited financial resources. Relatively inexpensive with a 24% markup on ex-factory price per district (12% by umbrella organization and 12% by each individual district).

•Good warehousing and transportation coverage. Virtually every neighborhood is known and could easily be reached.

•Organization is very well connected to similar organizations in other cities. If the product does well in one city, it can quickly get good coverage in other cities.

Disadvantages

•Organizations are more reactive than proactive. Therefore, they aren't very aggressive with their distribution means.

•State-owned Distributors have a questionable level of product promotion and merchandising efforts.

•These organizations have reputations for failing to aggressively develop new accounts or provide timely feedback for new market development.

•There is a lack of informational technology infrastructures with State-owned Distributors. They have no reliable computerized order taking, delivery confirmation, and accounts collection information systems.

•The State-owned Distributors are unable to provide Beijing Oasis with timely information regarding status of consigned products.

•There is difficulty determining sales and payment patterns on both individual accounts and consolidated district basis. This means a chronic delay in payment due to so much paperwork.

•Lavoie would need to hire up to 6 sales representatives to ensure promotion, account prospecting, and collection.

Financial Impact

The financial impact of this alternative is great because the simple fact exists that Lavoie would need to hire six additional sales people to help acquire more accounts. This costs 36,000 Rmb per year per sales person, totaling 216,000 Rmb. Also, promotional expenses need to be considered because they are not included in the State-Owned Distributor service. Promotional expenses for competitive foreign distributors are about 5% of total sales. Therefore, I estimated that 5% of the sales figure of $1,000,000 or 8,280,000 Rmb would be needed for promotional use. This equates to about 400,000 Rmb and $48,300. These figures are represented in Exhibit.4, as well as the break-even analysis. Selling price to restaurants would be 8.37 as seen in Exhibit 3.

Alternative #2

Distribute my means of Foreign Distributors. There are two companies Lavoie is considering. These companies are the East Asia Trading Company and DCH. This alternative features the 10% markup plan that includes simply warehousing and delivery.

Advantages:

•Both companies have established strong reputations for providing a wide range of trading, transportation, and distribution services and support functions.

•Cheap method of distribution with only a 10% markup on the ex-factory price.
•These companies are run well with reliable warehousing and transportation services.
•These companies have professional management. Information systems are in place as well.
•These companies have much experience in the distributing industry.
•Quick analysis of performance in the market with their information systems.

Disadvantages
•Lavoie is responsible for promotional activities and receivable collections. For this, he may need to hire sales personnel.
•Very limited coverage. They may need to outsource warehousing and transportation services due to inadequate coverage.
•It is not a full network as of yet.
•There is a lack of ability to collect outstanding accounts.
•Manufactured product is purchased on a 90-day credit policy. Extending credit to Chinese companies can be risky. The distributor then sells on credit to the customers who have a difficult time paying the distributor. A triangular debt trap results.
•Ever-changing regulatory regime in China could hinder the distribution process.

Financial Impact

The financial impact of this alternative is that warehousing and delivery are taken care of, but promotion and means of receivable collections isn't accounted for yet. Promotional expenses would be similar to alternative one at about 5% of total sales. Their selling price at the 10% markup is 7.43 Rmb to restaurants. This can be seen in Exhibit 3.

Alternative #3

Distribute by means of a Foreign Distributor using the 25% markup plan that includes delivery, warehousing, and promotion.

The advantages for this alternative are the same as in Alternative #2 plus these additional advantages:

•These companies have proven ability to promote goods.

•They have an adequate level of marketing and promotional support for Beijing Oasis' products.

•It would not be necessary to hire sales personnel.

Disadvantages are also the same except hiring sales personnel plus one additional disadvantage:

•Lavoie is still responsible for receivable collections.

Financial Impact

With this alternative, promotion is taken care of by the distributor. Therefore, the 5% of sales method doesn't need to be taken into consideration. However, Lavoie incurs a cost of 25% markup, raising the price of the product to 8.44 Rmb to restaurants. However, the cost of collecting receivables isn't taken into account yet. Therefore, Lavoie needs to create a method to do this. It is doubtful that this will occur for less than a 10% markup due to the lack of resources the new company has. These numbers can be seen in Exhibit 3 as well as the break-even analysis in Exhibit 4.

Alternative #4

Distribute by means of a Foreign Distributor using the 35% markup plan that includes delivery, warehousing, promotion, and accounts receivable collections.

Advantages of this alternative are the same as Alternative #2 plus these additional advantages:

•Virtually all responsibility is off Lavoie and in the hands of the distributor.

•No sales personnel would need to be hired.

•There would be more time available for analyzing market performance and product development.

Disadvantages are the same as for Alternative #2 except hiring sales personnel with one additional disadvantage:

•Most expensive alternative with foreign distributors.

Financial Impact

This alternative shows a 35% markup that raises the price of the product to 9.11 Rmb to restaurants. With this alternative, no additional costs are incurred. Although it is the most expensive alternative per unit on paper, additional promotion and receivables collection won't be added later. Also, this option leaves an opportunity to change if adequate promotion isn't performed during the first year. Lavoie could change to a different plan if he feels the distributor did a poor job promoting his product. This gives him time during the first year to analyze market performance and new product development. These figures can be seen in Exhibit 3. Break-even analysis can be seen in Exhibit 4.

Alternative #5

Distribute by means of establishing an Independent Network.

Advantages:

•Due to the upper-level incomes of the six friends involved in the network, they already know many promising restaurants in which the nectars could be sold.

•Partners feel they would benefit from knowing many of the owners of the restaurants. They felt the owners would have a greater willingness to try the unique and more expensive nectars due to the acquaintance.

•Lavoie felt with a 35% markup, the six members would have sufficient incentive to promote the product aggressively and alleviate problems expediently.

•Lavoie expected that the company would enjoy prompt payment from the partners because they are counting on friends and acquaintances.

•Lavoie felt that establishing an independent distribution network provided Beijing Oasis with the greatest degree of self-control and flexibility in responding to new market developments.

Disadvantages:

The friends' knowledge of Tianjin was very limited as compared to their knowledge of Beijing. This brought about questions of fairness in territories for the six partners.

•Each partner would eventually need to sub-contract warehousing and transportation services because only limited volumes could be handled using each individual's apartment and vehicle.

•Inconsistent levels of delivery service could develop.

•Lavoie recognized that friends might intrude on other territories than their own especially with such a strong incentive to sell.

Financial Impact

The financial impact of this alternative is rather uncomplicated. If Lavoie chooses this alternative, a 35% markup on the selling price would be implemented giving the unit price a cost of 9.11 Rmb to restaurants. The break-even calculation in units of 1,226,667 can be seen in Exhibit 4.

Recommendation

I recommend that Lavoie choose Alternative #4. Under this alternative, all warehousing, delivery, promotion, and receivable collections are taken care of. He will not need to hire additional personnel for promotion nor would he need to implement a personal information system for receivables. Also, if he felt the foreign distributors weren't performing well enough with their promotional activities and receivable collections, he could change plans and start his own promotion and receivable collections plan. Therefore, this is the most lucrative decision.

Implementation

Implementation begins by contacting one of the two Foreign Distributors Lavoie is considering and organizing a meeting. A one-year contract must be made for the 35% markup plan. The contract should be relatively short term in care Lavoie isn't satisfied with the distributor's promotion and receivable collections performance. The financial implications are shown in Exhibits 3 and 4.

The last step in the implementation process is to begin manufacturing the nectar and start the distribution process. With every aspect taken care of, Lavoie will have time to help manage the manufacturing of the product and analyze market data and performance. He can then make decisions as far as new product development or improvements to the existing product.

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