The Japanese Distribution System (Part 2)

By Sadahiko Nakamura

In the previous issue I explained that the Japanese distribution system is an efficient business system that enables importers and manufacturers to establish nationwide markets even though importers and manufacturers do not possess an autonomous sales force or a base for the flow of goods.

In the Japanese-style product distribution system standard retail prices as well as retail and wholesale margins are, in principle, set by manufacturers or importers (Figure 1). The Japanese distribution system's pricing structure is strikingly different from its European and U.S. counterparts. The system's characteristics are explained in the following sections.

1. Margins based upon the final retail price

Figure 2 shows an example of the pricing structure for typical general merchandise such as household sundries or personal gift items. In the Japanese distribution system, margins are not ordinarily a ratio (percentage) of the buying cost, but are instead expressed as a ratio (percentage) of the suggested retail price. The suggested retail price plays an important role in establishing the basis for distribution margins at each stage in the distribution system. Taking the price for the consumer that the Japanese manufacturer or importer has decided upon as 100%, the margin rate is 40% for the retail outlet and 12% for the wholesalers on average. So for an item whose list price is ¥1,000, the retailer would purchase it from the wholesaler at ¥600 and the wholesaler would purchase it from the manufacturer or importer at ¥480.

2. Priority given to setting affordable end-user prices

Japanese manufacturers and importers give careful consideration to prices in the market and competitive conditions related to quality in determining prices that are acceptable to consumers and undertake thorough advance market research in order to decide upon appropriate end-user prices for their products. The decision regarding end-user pricing is the essential point because it subsequently determines success or failure in the competition for sales. If a product faces little competition, unnecessarily low pricing is not required and if a product is in a fiercely competitive market it is necessary to employ a low-price, high-volume sales strategy.

3. Guaranteeing distribution margins

Throughout the world it is a given that businesses desire the guarantee of stable margins. As I pointed out in Number 1 above, in the Japanese distribution system margins are based upon fixed rates, and applied to the suggested retail price at each stage of distribution. As such, retailers and wholesalers can count upon a margin that is a stable, fixed percentage of their sales figures.

Further, Figure 2 shows that for household merchandise, for example, if the product has a ¥1,000 list price a retailer can expect a ¥400 margin from the outset and a wholesaler can look forward to a ¥120 margin, allowing them to invest systematically in marketing expenses.

In Europe and the U.S. on the other hand, one often sees a type of "pyramid add-on pricing structure" in which the margin is added on to the buying cost before a product is sold. Store owners then unavoidably find themselves in a situation in which they are always assailed by fears that their customers are being taken away by business competitors who add margins that are smaller than their own in order to sell more cheaply. As a result, they waste time and energy on price competitions with other stores, giving rise to concerns that investment in the important aspects of business, that is, maintaining and improving the quality of their goods and services, will be neglected.

Fig. 1

Product Pricing System for Easy Distribution

4. Setting appropriate product procurement costs in keeping with retail pricing

Market research determines retail prices that consumers will be able to afford. Because retail and wholesale margins are generally based upon retail prices in any given industry, Japanese manufacturers and importers can always calculate sales prices for wholesalers (¥480 in the case of the ¥1,000 household merchandise item in Figure 2).

When a Japanese manufacturer or importer sells a product to a wholesaler the unit cost is composed of the manufacturing (or import) cost and the manufacturer's (or importer's) margin. As such, the manufacturer's (or importer's) actual costs are set after deducting an acceptable manufacturer's (or importer's) margin from the wholesaler's sales price. Japanese corporations endeavor to employ all possible means, such as rationalization of production and procurement of materials, in their attempts to keep manufacturing and import costs within set limits.

5. Setting retail prices which include sales promotion costs in order to create demand

When the possibility of a high volume of sales ties in with simply acquainting the consumer with the product, the huge sales promotion costs that are required can be raised by making the list price a bit higher (or reducing distribution margins) and raising the Japanese manufacturer's or importer's margin. Innovative products in particular require thorough advertising with a large amount of public relations on TV and through other media, and this is made possible by providing the manufacturer or importer with the right to set pricing.

Product performance depends on appropriate pricing, a wide selection of products, convenient and comfortable shopping, rapid and reliable product services, and dealing courteously with customers, among other things. As we explained in the August/September 1992 issue, for products other than fresh foods and other daily essentials the Japanese consumer strongly insists upon product performance that goes beyond appropriate pricing. As such, when devising strategies for marketing products in Japan, companies should make sure to guarantee margins that will be large enough to provide the funds that will keep the customer satisfied. JJTI

Akihabara, an electric appliance sales mecca.

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Fig. 2