The Distribution System in Turbulence

By Uehara Yosuke

The Japanese distribution system is in the midst of unprecedented convulsions, coined by the media as "turbulences in distribution" with the key phrase being "price busting." Intense price-cutting competition is occurring everywhere: department stores, supermarkets, discount stores, local retailers, restaurants and housings. A stronger yen and deregulation have been fueling this trend, with retailers being forced to cut prices in the face of a consumers' revolt since the bursting of the bubble economy.

Price busting has also accelerated changes in the relationships between department stores and supermarkets and wholesalers and makers. To circumvent the distribution process, some wholesalers have been cut out completely. Makers have found themselves more often unable to impose standard retail prices on their products. Even national brand makers have been forced to engage in business tie-ups with department or super stores to supply the latter's private brands.

Price busting mechanisms

There are a number of internal mechanisms which have spurred this situation. The first is an imbalance between demand and supply. Unlike the past, today's Japan has a surplus of goods, which in turn necessitates lower prices. The second is imports from developing countries, especially from Asian countries, which have been increasing. Due to substantially lower material and labor costs, these imports are more price competitive than domestic products. Moreover, these imports are no longer "cheap as they were, bad as well," but improving in quality.

Thirdly, shorter and alternative distribution processes have been implemented. Shortening the process reduces distribution costs and enables lower retail prices. Examples can be found in parallel imports, mail order systems, door-to-door delivery services, and door-to-door selling.

The fourth is the appreciation of the yen, with it being traded against the U.S. dollar at a rate below ¥100. Reflecting the yen's strength, recent prices for foreign cars, like Benz and other foreign brand goods, have substantially fallen. "Some foreign brands are priced in Japan at two or three times higher than overseas," said Sakakura Yoshiaki, president of the major department store Mitsukoshi. "We are trying to narrow the price gap to around one and a half." This statement allegedly contributed to reducing foreign brand prices. A stronger yen has also accelerated a recent boom in personal imports. Lastly, changes in the tax system, falling prices in those goods no longer produced, and circulation of discount goods released by liquidated makers have been factors.

Weak consumer spending

Consumer spending has a big impact on the Japanese economy, with consumer demand accounting for about 60% of the GNP. Studies used in tracking consumer spending include the Family Income and Expenditure Survey, Department Store Sales, Supermarket Sales, New Car Registration, and Housing Starts.

"Consumer spending generally remained stagnant in the fiscal year through March 1994," according to the "White Paper on Economy" for fiscal 1994, "with final private consumption rising only 1.3% year-on-year in real terms, following a 1.1% rise in the previous year. The Family Income and Expenditure Survey by the Management and Coordination Agency also shows average household spending fell 0.6% year-on-year in real terms in fiscal 1993, following a 0.5% decline in the previous year. Looking at the supply side, both department store and super chain sales in fiscal 1993 fell sharper than the previous year. Reasons for the decline in consumer spending have been linked to lower real income, weaker consumer confidence, and negative impacts from relatively cold and rainy summer."

The summer of 1994 saw, on the contrary, an unusually hot summer, which pushed supermarket sales up year-on-year in July and August. However, sales dropped year-on-year again in September. Depressed sales have been quite severe in department stores.

Bleak stories continue. According to the Private Wage Survey by the National Tax Administration Agency, the average salary for workers in private companies during 1993 fell by ¥26,000, or 0.86%, from a year ago to ¥4.52 million. This was the first year-on-year drop in average salary since 1949, when this particular survey began.

Also, the shopping spree during the bubble, led by brand goods targeting young female office workers, burst with the bubble. Now the media, which instigated the splurge, has shifted its focus on introducing selected cheap goods and is recommending private imports for young female workers.

Daiei's private brand strategy

Suppliers have had varying responses to price cutting. Daiei has chosen to develop private brands with a price range 30-50% lower than national brands. "We want to cut consumer prices by half by 2010," says Nakauchi Isao, both chairman and president of Daiei, Japan's largest super chain with annual sales of ¥2.73 trillion. Developing private brands is a strategy for establishing an alternative distribution system that would allow lower purchasing prices. By summer 1994, Daiei had developed over 320 items for its own brands, including laundry soap, diapers and films. These products account for 12% of Daiei's total sales. This ratio is still low, but I believe the figure will rise quickly as Daiei continues to introduce new private brand items.

Daiei's home appliances sell under the Coltina brand. Small-sized refrigerators are supplied by the national brand maker Nichiden Home Electronics on an original equipment manufacturing (OEM) basis. Private brands of super chains are usually produced by minor makers. Recently, however, some national brand makers started to undertake OEM supply, as shown by the above case. This is because national brand makers, currently suffering from the recession, are exploring avenues of supplying private brands, which can guarantee a sufficient lot.

Cooperative unions are also entering the private name brand field. Eleven major cooperative unions, including Co-op Kobe, on October 21, 1994 introduced seven private brand items, such as cheese, and are developing 15 additional items to be introduced by March. To the industry's surprise, suppliers of these new items include major makers such as Morinaga Milk Industry. Combined annual sales of the 11 co-ops, or COMO Japan (Japan Cooperative Stores Modernization Organization), reached ¥1.3 trillion, comparable to that of Ito-Yokado (¥1.536 trillion). Sales of all cooperative unions, including COMO Japan, are estimated at ¥3 trillion, representing the largest single group among Japanese distribution industries. In this respect, cooperative unions need to be watched. The COMO Japan group also conducts joint purchasing to reduce costs, involving about 50 makers.

In this way, price cutting is quickly progressing among supermarkets and cooperatives. "We must try to offer valuable goods for consumers at reasonable prices," said Suzuki Toshifumi, president of Ito-Yokado, a rival to Daiei. "We are pursuing value rather than price." This position has been crystallized in the operation of Robinson, a department store within the Ito-Yokado group whose goods are priced one rank higher than Ito-Yokado's. Its high recurring margin ratio reportedly attracts many top executives in other department stores to visit Robinson.

Seibu's drastic restructuring

Most of 117 department stores joining the Japan Department Stores Association have seen their financial balance deteriorate. This is the result of extravagant investment during the past bubble period for higher grade stores and merchandise. Many department stores are currently undertaking rapid restructuring measures, for example, closing down unprofitable outlets, reforming sales floors, and revising their merchandise assortment as well as price zones.

Among 20 department stores whose shares are publicly listed, three—Mitsukoshi, Yokohama Matsuzakaya, and Sanyo Department Store (in Himeji City, Hyogo)—reported losses for the fiscal year ending March 1993. Including those unlisted, there are over 20 department stores showing losses. Yokohama Matsuzakaya (former Nozawaya, annual sales ¥25.8 billion), an old establishment with a history of 130 years, is speculated to be giving up reconstruction to a merger with its cross-share holding partner, Matsuzakaya.

Only Mitsukoshi (annual sales ¥800 billion) reported losses among major listed department stores. It is widely believed, however, that other major department stores are also financially not good despite their reported profits in recurring income.

Seibu Department Store is known among department stores hard hit by the recession for the harsh restructuring measures it has undertaken. The then Chairman Wada Toshiaki (current president), who returned to Seibu in 1992 after a stint as president in a subsidiary for 10 years, took painful measures in which the 36 company executives were forced to take responsibility for the company's financial deterioration. Eleven were demoted and 18 left. The then President Mizuno Seiichi, who had been much praised as a competent young manager, was demoted to vice-president, a position he soon quit. Wada also relentlessly rationalized unprofitable sections and cut wages. Since March 1994 sales floors have been reformed to meet consumer needs.

Supermarkets and department stores have implemented full-fledged low price strategies around autumn last year. Daiei has increased sales profits by developing a stream of "price buster" products.

Also, Seibu is developing its private brand items in bags, suits, shirts and cosmetics. In short, Seibu has changed its strategy into a radical shake-off of fat accumulated in the bubble period.

Skylark's transformation

Skylark, the major Japanese family restaurant chain, has also been hard hit by the current downturn in consumer spending. Beginning around 1990, the company started to lose customers, recording losses for fiscal 1992 and fiscal 1993. President Chino Tasuku responded by turning to a low price strategy. In July 1993 existing Skylark shops were transformed into Gusto, a lower-end restaurant chain; within eight months, 453 Skylark outlets had been transformed. While typical prices in Skylark restaurants range from ¥700 to ¥1,000 for one meal, Gusto's menu offers a meal for one coin (¥500); hamburg steak, for example, goes for ¥380 to secure customers amid the recession.

In the meantime, Skylark also launched two higher-end restaurants, Yesterday (an Italian restaurant) and Skylark Gardens, as it perceived a trend of polarization in the restaurant industry. Yet, overall, the company is overwhelmingly geared to low-end outlets. As of the end of September 1994, there were 344 Skylark outlets, 453 Gusto, and one Yesterday and one Skylark Gardens restaurant.

One-coin menus are made possible by a number of marketing schemes, less items on the menu (Gusto has only 30 items, compared to 100 to 130 at Skylark), introduction of a self-service system for coffee, and joint purchasing. At its early stage, Gusto saw exceptionally high growth in sales, partly helped by its novelty as well as cheap prices. Now growth rates are stabilizing, but at a high level.

MacDonald Japan, whose profits fell in 1993 for the first time since its start 23 years ago, launched a sales campaign from last September 2 to 18, offering ¥100 burgers, normally priced at ¥210. It sold 27.5 million burgers during the campaign, 18 times higher than 1.54 million recorded during the same period last year. President Fujita once said "A sudden sharp price cut is possible" if the yen strength continues. Thus, for Fujita, who is said to be a marketing genius, the ¥100 burger experience could be a sign for a potential strategic change to a low price orientation.

Gusto has implemented far-reaching labor reductions and differs widely from the usual family restaurant. Low-price menus are popular among consumers, resulting in long lines at lunch time.

Pros and cons of price busting

As seen above, the Japanese distribution market is overwhelmed by price busting. However, some anti-price-cutting goods are successfully competing. They are, in the words of Ito-Yakado President Suzuki, "value oriented."

"Emmi, the premium Swiss yogurt," introduced March 1993 by Morinaga Milk Industry, is a typical example. Unlike conventional fruit yogurt, which is a mixture of fruit jam and plain yogurt, Swiss Emmi uses fresh fruit. It is priced at ¥150, while most other fruit yogurt products are around ¥120.

Other successful anti-price busting goods can be found in potage soup, Chinese noodles, curry mix, chocolate, juice, instant coffee, shampoo and bath soap.

Considering these trends, consumers seem to be seeking lower prices for daily necessities, but willing to spend premium for new functions or effects for fancy goods.

Is price cutting good for the economy? While certainly welcomed by consumers, professionals are questioning if we should embrace this trend without reservation.

Those who believe price busting can be achieved through rationalization in management, such as Daiei's President Nakauchi, should lead companies to enforce this trend, and those companies could endure it.

However, for some distributors and makers, regardless of size, price busting means weaker earnings and balance sheets. These companies should, many professionals argue, be made to cut their labor force and shift their operations overseas. For those remaining workers, wages should be slashed. It would discourage consumption and ultimately lead to diminishing company profits. In any case, it will take time to evaluate the overall impact of price-cutting measures on the Japanese economy. However, one thing is certain: the ability to manage for the supply sector (distributors and makers) is now being tested. JJTI

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