New Distribution Revolution Catching On

By Hamano Takayoshi

Marking their first foray into the Kyushu market, two new types of fresh food outlets opened at the end of June in the food section of a department store in the center of Miyazaki, a city of 300,000 people in the southwest of Japan.

Drawn by discounts of more than 30% off regular prices, shoppers formed queues and opening day saw scores of people scrambling over each other as they rushed to snap up bargains.

The two outlets—the New Quick butcher shop and fruit and vegetable retailer Kyushuya—are both Kanto-based "category killer" chains in the fresh produce sector.

"Category killer" Kyushuya is expanding its fruit and vegetable outlets throughout the country in suburban shopping centers, department stores and power centers.

Trendsetters

"Category killer" refers to the type of discount store that carries a limited variety of products, but ample stocks and low retail prices. The marketing techniques em-ployed to attract customers in the fresh produce sector include cutting tuna up while customers watch, slicing meat to order to emphasize freshness, and stacking vegetables to the ceiling.

Department stores and shopping arcades in the vicinity of train stations, which have been losing customers due to competition with supermarkets, have begun to invite these chains in. Category killers have low start-up costs, stock products shipped directly from producing areas, offer discounts up to 80% to 90% when it appears that unsold produce will go bad, and hold huge sales. In addition to the over-the-counter sales of department stores, the sales appeal of these growing venture businesses is based on a new sales formula which incorporates volume retailer-style price slashing.

The new types of retailers appearing in Japan today are not limited to general discount stores or category killers, but take many shapes and forms: "power centers" that group several category killers in open mall-style shopping centers; the fashion industry's development of special casual clothing chains through the adoption of McDonald's-style fast food concepts, what might be referred to as "fast retailing"; or "wholesale clubs" that employ membership systems to sell large volumes of low-priced products to ordinary consumers; they are too numerous to count.

In quick succession, companies have expanded by using previously untried approaches in fresh produce, clothing, furniture, and other sectors. Seizing opportunities as the influence of department stores and supermarkets wanes, these trailblazers have appeared one after another in retail markets.

The 1960s saw the advent of the phrase "distribution revolution" at a time when Japanese supermarkets were also laying the groundwork for growth. The theory that retailing could be revolutionized by adopting U.S.-style, high-volume distribution systems was on everyone's lips. Now, some 30 years later, a new distribution revolution is on the horizon. However, the complexity of Japan's distribution system is world renowned and has also become a factor in trade friction. One wonders whether much will change.

Inefficiency

Distribution sector statistics compiled by the Ministry of International Trade and Industry show that in both the wholesale and retail spheres Japan has an enormous number of outlets. At 120 per 10,000 people (in 1994), Japan had a huge surplus of retailers compared to the U.S., with a mere 60, and Europe, with just 61 to 81 in France, western Germany, and the U.K. (1990 statistics for non-Japan figures). Against Japan's 34 wholesalers per 10,000 people, the U.S. had 16, or less than half, while France, Germany, and the U.K. had 23 to 30.

Companies in Japan's distribution industry are characterized by their small size—as of 1994, approximately 99% of both wholesalers and retailers had fewer than 50 employees. While the number of larger outlets is increasing, the overall percentage is still low.

Moreover, Japan's distribution channels are engaged in a variety of functions and their margins are high. They are also characterized by a growing number of business transactions in which the breakdown of costs and expenditures among the functions remains unclear. This has been mentioned as the reason for cost-cutting difficulties and pricing mechanisms that fail to function.

The pricing of men's dress shirts is a case in point. According to data compiled by Toray Industries, a major synthetic fiber manufacturer, raw material costs for a ¥5,800 cotton and polyester blend shirt—¥53 for the raw cotton, ¥17 for the polyester, and so on—amount to a combined total of only ¥220.

Manufacturing costs, including creating the cotton yarn, weaving and dying the fabric, and finally sewing, comprise 27% of the final sales price. In addition, product planning and brand name creation, along with the cost of the apparel manufacturer that plays the pivotal distribution role and the margins for trading companies, wholesalers, and retailers, all add up to 73% of the distribution costs.

If the sewing could be contracted for 20% less overseas, distribution routes shortened, and distribution expenses greatly reduced, provisional calculations would yield a cost of ¥2,980 per shirt. Actually putting this into practice would require a tremendous overhaul of business practices, evidently not an easy task.

The bottleneck to the attempts to reform the distribution system has been the sector's role, both socially and within companies, in absorbing excess employment from other sectors. In other words, the point remains that there are fears that if the distribution sector was put under the knife in an attempt to improve efficiency it would create uneasiness regarding employment.

Systemic fatigue in Japan-style systems

Attention should also be paid to the pricing revolution which has occurred simultaneously with reforms to the distribution system and the ongoing revisions to pricing standards. Affected by falling prices, Japan's fiscal 1994 growth rate expanded 0.6% in real terms, taking commodity price increases into account, but the nominal growth lagged at just 0.3% and government tax receipts and corporate earnings tended to be held in check without an increase in the nominal growth rate.

Taking the above into consideration, many are concerned that the economy has slipped into a deflationary recession (a first for the postwar period), and comparisons with the "Showa panic" of the 1920s—when the average annual real growth rate of slightly less than 2% was maintained from 1920 through 1931, but the nominal GNP fell 16% and the economy entered a severe recession—are being made.

Slow declines in commodity prices lead to reductions in corporate manufacturing costs and are also linked to higher real incomes for average consumers, so this is not thought to be entirely bad, but this outcome is not guaranteed.

For this fiscal year, the government compiled a supplementary budget centering on reconstruction following the Kobe earthquake and alleviating the strong yen's impact on smaller firms. Business circles then immediately began forcefully demanding a second supplementary budget and other economic stimulus measures, putting the government on the chopping block.

However, some cognoscenti have begun to doubt that simply piling up public expenditures or cutting the official rate from an annual 1% to 0% to see the results will lead to an actual recovery for Japan's economy. According to this view, the Japanese-style economic system that has been sustained for the half-century following the war is suffering from systemic fatigue.

As such, a real economic recovery is not anticipated without accompanying structural reforms to the economy. Specifically, this means that authentic deregulation must be promoted to spark lively competition and systems must be created to support innovative activities designed for an advanced information society. Changes in perceptions across the whole of Japan's economy and society will be vital to these systemic reforms.

In that sense, the enthusiasm of the trendsetters who have started to appear in the distribution sector will undoubtedly provide great incentives.

While it is not anticipated that Japan's elephantine, complicated distribution systems will change overnight, white knights have appeared to take on the challenge of rebuilding a system afflicted with systemic fatigue. It will be interesting to see just how far the new distribution revolution will progress. JJTI

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