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Leveraging Distribution to Maximize Firm Performance in Emerging Markets☆

V. Kumar[a,b,c,*,1], Sarang Sunder[c,1,2], Amalesh Sharma[c,1]

[a] *Regents' Professor, Richard and Susan Lenny Distinguished Chair Professor of Marketing at Georgia State University, United States*
[b] *Chang Jiang Scholar, HUST, China*
[c] *Center for Excellence in Brand and Customer Management, Department of Marketing, J. Mack Robinson College of Business, Georgia State University, Atlanta, GA, United States*

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Abstract

Despite the rise of emerging markets as lucrative destinations for business expansion, marketing literature in this area is largely anecdotal and conceptual. Further, owing to the largely unorganized retail structure in emerging markets, managers tend to make sub-optimal marketing-mix decisions by taking an aggregate view of their distribution network. In this study, we develop an econometric model to help firms develop a multichannel distribution strategy in emerging markets while accounting for (a) own-marketing mix, (b) competitive actions, (c) brand-level heterogeneity, and (d) dependencies that may arise between product offerings. The proposed model is tested on longitudinal data from a large Indian CPG manufacturer. The results indicate that firms must consider store format-specific distribution elasticities (as opposed to aggregate effects), especially in an emerging market, where the role of distribution is critical in brand success. Further, depending on the offering, price (own- and cross-) and advertising elasticities could vary even though the brand is essentially the same. Also, we find that there are significant dependencies between product forms that need to be considered when designing the marketing mix. Finally, we provide re-allocation recommendations to help managers choose the level of store format distribution in order to maximize profits. The proposed distribution re-allocation strategy resulted in an average of 7.7% increase in profits across three product forms for the focal firm.
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Keywords: Multichannel retailing; Emerging markets; Distribution elasticity; Store formats; Marketing mix; Product forms

Introduction

With the rise of globalization and the saturation of developed markets, consumer goods manufacturers (both domestic as well as multinational), have started diverting their focus to the emerging markets instead, since they provide a plethora of growth opportunities and are slated to grow almost three times faster than the developed economies between 2013 and 2020, accounting for almost 65% of global economic growth.[3] Further, it has been predicted that by the year 2035, the Gross Domestic Product (GDP) of emerging markets will permanently surpass that of all advanced/developed markets (Wilson and Purushothaman 2003). Emerging markets such as the BRIC countries (Brazil, Russia, India, and China) have become preferred destinations for multinational corporations because of several factors such as their promising growth potential, continuous economic reforms, higher proportion of young population, the worldwide liberalization of trade and investment, the regional integration of economies such as ASEAN, the emergence of a new middle class with high purchasing

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* Corresponding author. Tel.: +1 404 413 7590; fax: +1 832 201 8213.
E-mail addresses: vk@gsu.edu (V. Kumar), ssunder1@gsu.edu (S. Sunder), asharma14@gsu.edu (A. Sharma).
[1] All authors contributed equally to this work.
[2] *Present address*: Department of Marketing, Neeley School of Business, Texas Christian University, Fort Worth, TX 76109, USA.

[3] http://go.euromonitor.com/Reaching-the-Emerging-Middle-Classes-Beyond-BRIC.html.

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power, the democratization of technology, and the rise of local entrepreneurs.

However, marketing in these economies is easier said than done since conventional marketing strategies may not apply in the emerging market setting. Sheth (2011) outlines five key characteristics of emerging markets that make them radically different from traditional, developed economies: market heterogeneity, sociopolitical governance, chronic shortage of resources, unbranded competition, and inadequate infrastructure. These characteristics compel marketers to rethink traditional marketing strategy and practice in emerging markets. While several multinational corporations have been lured by the prospect of retailing to the millions (if not billions) of consumers in emerging markets, very few have actually succeeded (Dawar and Chattopadhyay 2002; Khanna and Palepu 1997). Although marketing literature focusing on the impact of the marketing mix on sales is rich (Assmus, Farley, and Lehmann 1984; Tellis 1988; Wilbur and Farris 2014), this knowledge is almost exclusively derived from high income, developed and industrialized countries. This presents a unique challenge faced by firms that need to adapt their marketing mix to growing demands in emerging markets, since knowledge concerning marketing in emerging markets is scarce (Burgess and Steenkamp 2006).

Past research has often stressed on distribution and retailing as being one of the biggest challenges of doing business in emerging markets (Arnold and Quelch 1998; Reinartz et al. 2011). Specifically, the dominance of the unstructured retail in emerging markets increases the complexity of marketing mix. Most of the distribution network in developed markets is dominated by large retailers such as Walmart and Kroger who represent the organized retail. The organized retail sector is characterized by retailers who offer a large number of outlets (usually spread out nationally), large product assortments and large stores. In contrast to the organized retail setup, the unorganized retail sector is characterized by a large number of small, independently owned stores that stock fewer products. Sarma (2005) defines unorganized retailing as an 'outlet run locally by the owner or caretaker of a shop that lacks technical and accounting standardization'. Examples of unorganized retail include traditional store formats such as kirana stores, owner manned general stores, grocers, and street vendors. Although, the total retail sales in emerging markets are comparable to their developed counterparts (with the exception of the United States), the ratio of unorganized to organized retail differs greatly. For example, in China, the level of unorganized retail is 80%, while in Brazil, the percentage is 64%, and in India, the level is as high as 95% (Joseph et al. 2008). One of the biggest challenges when operating in highly unorganized and unstructured retail settings is that brand managers are forced to depend heavily on local intermediaries (wholesalers as well as retailers) to 'push' the brand in the market, leverage the brand across various retail formats and, therefore, ensure success of the brand. The distribution decision is more difficult to make since the unstructured nature of the market provides managers with little information (in the form of data) to make optimal distribution decisions. The complexity of the issue at hand is increased for CPG manufacturers (such as P&G) that manage brand portfolios (multiple brands), in multiple product forms,[4] across multiple distribution formats (small retailer, big retailer, mom and pop stores, etc.). Given this, CPG managers are faced with the challenge of aligning brand, store format and product form in order to maximize profits. While past research has outlined some of the challenges of retailing in emerging markets, most of the solutions proposed have been at a conceptual level, with little focus on empirical application.

In this research, we address the above challenges by providing an actionable framework that managers in emerging markets can use in order to maximize profits by optimally allocating distribution resources. To the best of our knowledge, this is the first study to empirically address the issue of brand, product form and store format alignment in an emerging market. Specifically, our research objectives are outlined below:

1. Quantify the differential impact of distribution channel formats on brand sales in an emerging market context.
2. Optimally allocate distribution resources across various store formats for each product form in order to maximize profits.
3. Assess the impact of competition and other marketing mix elements on brand sales.
4. Explicitly account for inherent dependencies across product forms that could influence sales.

Further, large CPG manufacturers (such as P&G) tend to market several sub brands (such as Ariel and Tide laundry detergents) in various product forms (such as liquid and powder forms). This adds an additional level of complexity to our modeling approach. In order to address the above methodological and managerial challenges, we propose a multiplicative seemingly unrelated regression (SUR) model of sales that accounts for the (a) dependencies across product forms (through a non-zero covariance matrix), (b) endogeneity of marketing decisions (through instruments), as well as (c) sub brand-level heterogeneity (through a random effects parameter). The proposed model was implemented on 5 years of data obtained from a large Consumer Packaged Goods (CPG) manufacturer, operating in the Indian market. Since our data includes specific information regarding the distribution channels (type and quantity), we are able to uncover the differential impact of each channel format and compare the most/least effective distribution channel formats within this market. In addition, based on the results of a non-linear optimization, we provide managerial recommendations on the distribution allocation decisions for each product form, in order to maximize profit. To the best of our knowledge, this is the first study to address all of the above issues in an emerging market setting.

In the empirical application presented in the study, we find that there is significant heterogeneity among brands within the market, and this heterogeneity needs to be considered at the

[4] Product forms pertain to variations within the same product category. They usually have similar functionality and purpose but differ in the usage. For example, deodorant brands in the US market offer their products in multiple forms such as aerosol sprays, solid sticks, or gels.