Role of Distribution Channel in Present Environment

By

Anil Motsara
Dy. General Manager (Mktg)
National Fertilizers Limited

ABSTRACT

The consumption of fertilizers in India is skewed and accordingly is its distribution. The distribution of fertilizers in India is enormous and complex. The role of distribution channel assumes a greater importance in present scenario. The paper covers the introduction of new policies by the Government for moving towards decontrolled scenario in fertilizer sector and its impact on fertilizer marketing. The paper also discusses the classification of distribution channel on the basis of their structure and functions. It also covers the role of intermediaries of distribution channel in the movement of products from producer/importer to the end user i.e. farmer.

INTRODUCTION

The production of fertilizers in India during 2014-15 was **126.83** LMT of Nitrogen and **40.17** LMT of Phosphates, thus registering a growth of 2.46% in Nitrogen and 8.16% in Phosphates over previous year. India's dependence on import is to the extent of 25% of our requirement of Urea, 90% in case of Phosphates, either as raw material or finished products(DAP/MAP/TSP) and 100% in case of Potash.

The enormity of fertilizer distribution can be assessed by the fact that about 540 lakh tonnes of fertilizer products have to reach the farmers spread over 32 lakh Km2 of area under 675 districts of the country. These fertilizers originating from 49 plants in 15 states and 19 ports in 8 states have to reach over 3 lakh sale points across the Country.

The complexity of fertilizer distribution lies in the fact that this distribution is to be made in conformity with the policies and guidelines issued by Government of India, over already existing Essential Commodity Act and Fertilizer Control Order.

The wide price variation in the MRPs and movement facility between Urea and other subsidized (P&K) fertilizers has led to an imbalance in nutrient use. This situation has been created by not including Urea under Nutrient Based Subsidy (NBS).

Nutrient Base Subsidy (NBS) : P&K V/s Urea

Nutrient based subsidy (NBS) policy was announced w.e.f. 1.4.2010. Under the NBS policy, the Government announces a fixed rate of subsidy (in Rs/Kg basis), on each nutrient of subsidized P&K fertilizers. At present 22 grades of P&K fertilizers, SSP and 16 grades of NPKS complex fertilizers are covered under the NBS policy. Urea has not been covered under the NBS policy.

Import of all the subsidized P&K fertilizers, including complex fertilizers has been placed under Open General License (OGL). NBS is available for imported complex fertilizers also except Ammonium Sulphate. Urea imports remains under the control of Government of India.

The MRP of fertilizers, other than Urea, after implementation of NBS w.e.f. 1.4.2010 has drastically increased. From 2009-10 to 2014-15, the prices of DAP has increased from Rs.9350/MT to Rs.24,500/MT, MOP has increased from Rs.4455/MT to Rs.16000/MT, SSP from Rs.3400/MT to 7300-8800/MT, NKP from 5804-7050/MT to 18500-24000/MT and Urea prices from Rs.5310/MT to Rs.5360/MT. This is being reflected in the drastic decrease in sales of subsidized fertilizers, other than Urea, as indicated in Table-1.

Table-1

(in LMT)

Year	Urea	DAP	MOP	NPK	SSP
2008-09	266	92	41	68	26
2009-10	267	105	46	80	27
2010-11	281	108	39	98	38
2011-12	295	102	30	104	47
2012-13	300	91	22	75	40
2013-14	306	74	23	73	39
2014-15	309	76	28	82	42

Source: FAI Statistics

The distribution of all fertilizers, whether indigenously produced or imported, is monitored through an online web based system - Fertilizer Monitoring System, popularly known as “FMS”.

50% of Urea and 20% of decontrolled fertilizers have been put under the movement control under ECA 1955. Although the movement is monitored/controlled on monthly basis through monthly supply plan finalized by Department of Fertilizers. This is mainly done to bridge the gap in supplies in certain areas identified through weekly video-conferencing with all the State Agricultural Department.

Freight subsidy for transportation of fertilizers is provided by Government. It is different for Urea and other decontrolled fertilizers.

In case of Urea and P&K fertilizers (except SSP) the rail freight is paid on actual, as per railway receipt. The primary movement by road is compensated upto 500 Km on the basis of district-wise lead identified in FMS from individual plant/port and road rate fixed by Department of Fertilizers on the recommendations of Tariff Commission. In case of P&K fertilizers (except SSP) freight subsidy for direct road movement from plant/port is reimbursed as per actual claims subject to equivalent rail freight to be announced by DOF from time to time but such movement is restricted to 500 Km.

Secondary freight, for movement upto block headquarter, is payable for Urea transportation. This is paid on the basis of leads of individual district fixed from the identified nearest rake point and the road rate fixed for the district. No secondary freight is payable on account of movement of P&K fertilizers (including SSP).

The market price of subsidized fertilizers (except Urea) is determined on the basis demand-supply dynamics. The companies are required to print MRP along with applicable subsidy on the fertilizer bags. In order to check the prices fixed by P&K fertilizer companies, the Government vide notification dated 8.7.2011 directed companies to fix the prices of P&K fertilizers at reasonable level under the NBS regime.

Changing Scenario

Till now the growth of fertilizer industry has largely been regulated by government and had very little scope for a flexible marketing mix.

Government's aim is to curtail the fertilizer subsidy burden has led to opening up of the fertilizer industry. NBS is a step towards it. Although not including Urea under NBS has created a divide amongst Urea and other subsidized fertilizers. With this the urea remains under seller's market scenario while other subsidized fertilizers have moved to buyer's market scenario. Apart from introducing NBS, Government has also tightened the norms of production and distribution for similar aim. This has affected the bottom-line of fertilizer companies.

Coping with the Changing Scenario

Marketing activities are consumer satisfaction centric. This is done through strategically evolving the marketing mix: Product, Prices, Promotion, Place and People – the 5 Ps of Marketing Management. The customer needs are to be assessed and necessary adjustments are to be made in the marketing mix to achieve the goal. The key function of the marketing mix is to facilitate the consumption by identifying and removing the hurdles.

In rural/agri-product marketing the marketing mix varies for different products and is mainly based on the market segmentation. Therefore, it is necessary to form sub-groups of the products having similar needs of a marketing mix.

Distribution Channel

Best management of distribution channel is one of the factors providing the success of products sold by a company in the market.

In the marketing mix, the process of delivery of product from the producer to the consumer at right time in right quantity is called 'Place'. By definition it is only the physical distribution or logistics of the product. Distribution has in itself a larger scope covering forecasting, demand generation, promotion, communication, after-sale service etc, apart from physical distribution.

In fertilizer and other agri-product marketing the role of distribution channel plays a special role, besides having its own advantages & disadvantages.

Types of Distribution Channel:

There are mainly three types of distribution channels. These are:

1. **Direct**: Manufacturer/Importer directly provides the product to the consumer. In such cases, the company owns all the elements of its distribution channel or sell through specific retail location or Agro-service centre. Benefits of this modal is that the company has complete control over the product, its image at all stages and the user experience.
2. **Indirect:** Company uses an intermediary to sell its product to the consumer. Number of intermediary may depend upon market segmentation, volume of sales desired, cost of the product, margin of sales, etc.

   This may raise product costs as each intermediary will retain their share of profits.

3. **Dual Distribution**: Company may use a combination of direct and indirect scaling. This type of channel utilization may help reach more consumers but there may be danger of channel conflict. Presently most of the fertilizer companies are using this type of channel.

Distribution Channel Intermediaries:

These are middlemen who play crucial role in the distribution process. There are four types of intermediaries:-

1. **Agents:** are independent entities who act as an extension of producer by representing them to the consumer/customer. An agent actually never gains ownership of the product. They usually make money from commissions and fees paid for their services.
2. **Wholesalers:** are independent entities, who actually purchase products from the producers. They own the title of the product, store them, transport them and further sell them to retailers/consumers.
3. **Distributors:** are similar to wholesalers. Distributor carries products from a single brand or company, whereas, wholesalers may carry a variety of products from different companies.
4. **Retailers:** sell the product purchased from wholesaler/distributor, to end user at a profit.

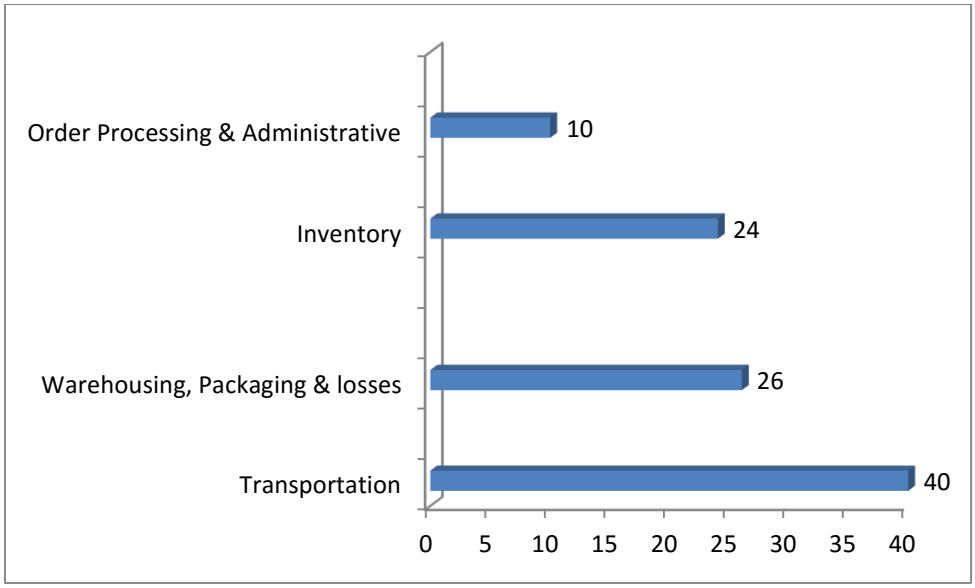
Role of Distribution Channel

Functions performed by distribution channel not only facilitates the flow of products but also provides information and support necessary for Management in decision making.

The functions performed by intermediaries in distribution channel are logistical, transactional and supportive in nature.

1. **Logistical Role**
   Besides physical distribution of products, logistic functions involve procurement, storage and supply of products.
   In India logistic sector is typically driven by the objective of reducing transportation costs that are exorbitantly high due to regional concentration of manufacturing or imports and geographically diversified distribution activities as well as inefficiencies in infrastructure.
   The transportation cost vis-à-vis costs of other elements of logistics are shown in Table-2.

Table-2



Transportation assumes importance in fertilizer sector, as part of it is subsidized by the Government (except SSP). The subsidy burden of the Government on the account is of the level of Rs.5000 crores. Judicious planning and appropriate use of rail-road mix will not only reduce the company's cost and curtail the subsidy burden of the Government but also positive impact on the presently skewed consumption of fertilizers.

In India goods are predominantly moved by rail and road. Road transportation is preferred due to its low cost and flexibility. More than 65% of total goods are moved by road. However, in fertilizer sector road is preferred over shorter distances and flexibility, whereas, rail is mainly preferred for long distance movement. The rail road mix in fertilizers sector is decided on the basis of Government policy of freight reimbursement. Presently 80% of fertilizers are moved by rail.

Apart from financial impact, the movement of goods also has its environment and social impacts. A comparison of environmental and social sustainability of rail and road transport is given in Table-3.

As India still lacks in last-mile rail and last-mile road links, the intermediaries, due to their locational advantages, can play a significant role in facilitating delivery of fertilizers till farmers.

TABLE-3

Energy Consumption	* As compared to road, rail consumes 75% to 90% less energy for freight traffic.
Financial Costs	* Unit cost of rail transport was lower than road transport by about Rs.2 per NTKM and Rs.1.6 PKM
Environment Damage	* Rail transport emits 17 gram CO2 equivalent PKM as compared to 84 grams PKM in case of road transport
Accident Costs	* For freight transport, road accident costs are 8 times that of rail
Social Costs (All inclusive costs)	For non-urban areas, the cost advantage of rail was as much as Rs.2.5 per NTKM and Rs.1.7 PKM.

Base year: 2000

Source: Report of the Working Group on Railways (NTDPC)

The consumption of fertilizers is limited to 6-7 months in a year but its production is continuous throughout the year. Due to deficit logistic infrastructure, even the imports are planned well before the commencement of consumption season. This entails well planned storage spaces to be hired by the companies. The all India availability of storage space with Government agencies like CWC & SWC is given in Table-4.

TABLE-4

No. of warehouses				Capacity ('000 tonnes)			
Central (CWC)		State (SWC)		Central (CWC)		State (SWC)	
31.3.2013	31.3.2014	31.3.2013	31.3.2014	31.3.2013	31.3.2014	31.3.2013	31.3.2014
469	471	1659	1689	10802	10494	25093	26696

Source: FAI Statistics

Since these godowns are also used for other commodities, they may not completely fulfill the needs of a company for strategic storage of fertilizers. In order to penetrate the market, the storage plays a crucial role. Utilization of small storage spaces with the intermediaries i.e. wholesalers and retailers would strategically spread the fertilizers for immediate availability to the farmers. These storage apart from being economically viable will also have lesser implications of secondary movement due to its location.

2. Transactional Role

The intermediaries in distribution channel play an important role in distribution transaction, which benefits all the members of the channel, including the end user. These include:

(a) Pricing: With the introduction of NBS, there is flexibility with the companies to fix prices of fertilizers (except Urea) based on acceptability of their product and demand supply situation. The producers/importers can invite suggestions from intermediaries, who are very close to the ultimate user, to know the MRP of a product. The prices may be different for different markets. The prices of fertilizers (except Urea) are fluctuating, the intermediaries at times absorb the fluctuation for keeping the prices stable. This is being done because of intra-channel competition and to liquidate the inventory, as the demand of fertilizers is price sensitive. The present prices of fertilizers entail high inventory costs. The intermediaries maintain prices to some extent by keeping their overheads low.

(b) Promotion: The promotion of fertilizer includes the transfer of technology from lab to land. Ensuring the visibility of the product, the efforts of the companies may not be sufficient, therefore, role of the channel is also required. Apart from displaying point of sale (POS) material, many channel partners design their own incentive programs, aimed at building customer loyalty.

(c) Financing: The necessary finances/working capital requirement is generated from the channel partners in form of advance payments. Although credit facility is also extended to the channel partners, the credit period is made encashable at an interest rate suitable to company and the intermediaries.

3. Supportive Role:

The distribution channel supports the producers and the end users in facilitating the process of distribution in number of ways:

(a) Information: The intermediaries have a role in providing vital information about the market to the producer. These could be like changes in customer demography, psychography, entry of new competitor or a new brand and changes in customer preferences. The distribution channel can also provide valuable information on the product and its acceptability, allowing product development. This comes at no additional costs, as the intermediaries are present close to customers/end-users.

(b) Credit: It has been observed that credit plays a vital role in the buying behaviour of the farmers. About 80% of farmers in the India are small and marginal farmers, most of them do not have surplus funds for cultivation. Thus for farming a credit is required in form of cash or agricultural inputs. Table-5 shows the credit allowed by Banks and other agencies for agriculture and allied activities. The process of obtaining credit from such institutes is cumbersome. Most of the wholesalers and some retailers provide fertilizers and other agri-inputs to the farmers on credit. This could be from their own resources or from the credit availed from the companies. Most farmers prefer this, as it is available with comparative ease.

TABLE-5

AGENCY-WISE GROUND LEVEL CREDIT FLOW FOR AGRICULTURE AND ALLIED ACTIVITIES
2008-09 TO 2013-14 (Rs/Crores)

AGENCY	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Cooperative Banks	45966	63497	78007	87963	111203	118422
RRBs	26765	35217	44293	54450	63681	83307
Commercial Banks	228951	285800	345877	368616	432491	521496
Other agencies	226		114			
Grand Total	**301908**	**384514**	**468291**	**511029**	**607375**	**723225**

Source: FAI Statistics

Distribution Channel Management

Seeing the importance of distribution channel in the marketing of fertilizers and other agri-products, it becomes all the more important to manage/service the channel on continual basis. Management of distribution channel involves strategies of Channel segmentation, designing, selection, mix, motivation, training and conflict resolution.

Channel Segmentation

In order to address the specific needs and requirements of distribution channel, it needs to be segmented. Number of benefits could be achieved through channel segmentation:

(a) Product Management: Relevant products may be provided to the right channel which can help in inventory cost reduction.
(b) Price Management: Price differentiation could be managed.
(c) Promotion Management: More targeted and specific promotional activities can be undertaken, with more clear and consistent messages.
(d) Efficiency in Operations: Time and resource wastage through the channel can be removed. Development needs of every channel segment can be addressed separately and in more targeted manner.

Channel Design

The channel designs are customized based on the moving ability of the product, its cost and turnaround required in terms of sales and realization. Channels are classified by the number of intermediaries between manufacturer and consumer. A level zero channel has no intermediaries i.e. company's own outlets. A level one channel has a single intermediary. This flow is typically from manufacturer to retailer to consumer. Fertilizer sector adopts varied channels, from zero level to level four.

Channel Selection

Channel selection is one of the most important part of distribution strategy and selection of channel depends on the desired type of distribution required for the product line of the organization. The types of distribution strategies include:

1. Intensive distribution: aims at wide coverage of the market by stocking at majority of outlets. Intensive distribution is required where the consumers have a range of acceptable brands. This is generally applicable for fertilizer sector as the fertilizers are more acceptable under generic names rather than brands.
2. Selective distribution: here the producers use a limited number of outlets. This strategy is commonly observed for more specialized goods or where the producer wants to establish preference for a brand. Such strategies can be adopted by companies who wish to establish separate channel for their other than fertilizer products.
3. Exclusive distribution: is an extreme form of selective distribution where companies select only few intermediaries for their product distribution.

Channel selection also depends on the buying behavior of consumers. Various consumer (farmer) surveys have revealed that the farmer's buying behaviour is mainly affected by the availability of fertilizers, price of fertilizers and the credit availability.

Channel Mix

Selection of channel mix would depend upon the sale volume and the product line of the organization. Fertilizer sector has mainly two types of channel i.e. private channel and the cooperative channel. Further in cooperative channel the distribution system various from state to state i.e. from 2 tier to 4 tier system. In private sector organizations have the flexibility of selecting the channel mix, which generally varies from level zero to level 2 of channel system.

Adding an intermediary can add to the cost of the product in the short run since it increases the number of people who get the share of the profits. However, in the long term it actually reduces the cost of distribution due to increase in efficiency and sales, which ultimately reduces the inventory carrying costs.

For fertilizers where the distribution margins are fixed, with the increasing levels of intermediaries, the profitability of each level reduces. In such situation economy of scales plays an important role and organizations must ensure appropriate volumes to their intermediaries from its product line.

Channel Motivation and Training

By definition motivation is the psychological feature that activates people to action towards a desired goal. Continuous channel motivation is an essential element to build a strong and vibrant network. Encouragement can be done through dealer conferences, special schemes, offering higher margins etc. On the other hand negative actions may also be necessary to maintain discipline and to discourage channel conflicts. Such actions could be in the form of cutting back margins, levying interest, holding back delivery of products etc.

Apart from providing the basic knowledge about the products, the marketing channel, the consumer etc, the channel training should also ensure that the distribution channel is able to provide market information and analysis since this will be important information for both the organization and the channel.

Channel Conflict

Generally channel conflicts occur when action of one intermediary affects achievement of goals by the other. Vertical channel conflicts occur between the different (in hierarchy) levels within the channel i.e between wholesaler and retailers. The horizontal channel conflict occurs between intermediaries at same levels within the channel.

The horizontal level conflict generally occur due to lack of proper communication from organizations, which can be easily resolved by having an improved communication system within the organization.

Till now, fertilizer companies have been limiting their conflict resolving mechanism for horizontal level conflicts only. However, with the implementation of mobile FMS and mFMS, which entails

acknowledgment of deliveries at each levels of channel, it would be essential for fertilizer companies to evolve conflict resolving mechanism for vertical conflicts also.

Channel Costs:

Before making a channel decision, producers may have to weigh the costs associated with distribution channel.

(a) Reduced Profits: Intermediaries need to be paid for their services or allowed to resell at a higher price. These margins have to come from the company's resources/margin of profits.
(b) Miscommunication: The message received by the consumer is also in the hands of the intermediary. There is a possibility of miscommunication, which could lead to customer dissatisfaction.
(c) Lower product Preference: The intermediary may have incentive to push another product first at the expense of others.