Chapter 5
Distribution Challenges in Emerging Markets: Evaluating Alternate Distribution Strategies for FMCG Firms in Rural India

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Abstract This chapter explores the distribution challenges in Indian rural market and evaluates the various strategies to approach rural markets. Reaching out to rural markets has been acknowledged as the biggest challenge. This chapter discusses various strategies used by firms to reach out to rural India. A set of six strategies of distribution in rural India has been identified. Major fast-moving consumer goods (FMCG) firms which have serious interests in rural markets have been using these strategies. The pros and cons of each distribution strategy have been elaborated. The critical discussion of these six distribution strategies and future recommendations is expected to enhance the understanding of marketers so that they can plan better for reaching to rural India.

Keywords Distribution strategies · Rural markets · Retailing · India
FMCG · Emerging markets

Introduction

Emerging markets, which account for 65% of the world's population, 40% of the world's economic output, are expected to grow three times faster than developed economies (Narasimhan et al. 2015). Many multinational firms, attracted towards emerging markets, have met with limited success in these markets (Dawar and Chattopadhyay 2002; Khanna and Palepu 1997), and the complexity of distribution channel is one of the reasons for their limited success (Kumar et al. 2015).

India, with around 17% of the world population, presents an enormous opportunity, and companies are stepping up efforts to unlock this opportunity. And within

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India, the most challenging part is the rural areas which are seen both as an opportunity and a challenge. The opportunity is based on the sheer population which resides in around 636,000 villages in India, and the challenge stems from the fact that reaching out to the consumers in these villages spread across the geography of the country. These villages are inhabited by about 850 million consumers making up for about 70% of the population and contributing around half of the country's gross domestic product (GDP).

Rise in rural prosperity across emerging markets is attracting more and more marketing companies. But, companies met with limited success because of inadequate distribution networks, partners with limited capabilities and long payment cycles. As reaching out to the rural markets in India, it is very expensive so the first step for any company is to design cost-effective distribution strategy to penetrate these markets. Moreover, firms face the challenge of replenishing products reliably and consistently. Inadequate transportation infrastructure, lack of warehousing facilities, widely dispersed consumers and limited local distribution channels were identified as some of the key external barriers to expand in rural markets (Satyam and Aithal 2017). Even the best conventional distribution systems have been unable to penetrate beyond about one-sixth of India's rural villages (Mahajan and Banga 2006). And to reach out to these markets, there is a need to develop innovative rural distribution models (Kashyap 2012a).

The attempt of this chapter is to document the various distribution strategies that FMCG companies have taken to reach out to these markets. Six distribution strategies, adopted by FMCG majors, have been identified, and a set of pros and cons of each of these approaches have also been identified. It is expected that this effort will help to understand the various strategies which can be used to distribute in rural markets across emerging economies and eventually lead to more efficient and innovative ways of doing the same in the future. The consumer population in an emerging market is dispersed over a wide geographic area, and transportation infrastructure, warehousing infrastructure, etc., are poorly developed. A critical analysis of distribution strategies in emerging markets is also required owing to the different distribution structure. The objective is to enhance the current understanding of academicians and practitioners and provide them a critical analysis of existing distribution strategies along with recommendations for future.

FMCG Business in Rural India: Opportunities and Challenges

It is expected that rural India will become the next growth engine, and they cannot be ignored (Kashyap 2012b). Manwani (2012) says by 2025; the Indian rural market is expected to grow more than tenfold to become a USD100 billion opportunity for retail spending. Urban demand across the world has been sluggish, and rural markets are growing faster than ever in some of the largest emerging economies. This phenomenon is evident in India as well where spending by 800+ million rural residents reached $69 billion, some 25% more than their urban counterparts spent over the same period (Kapur et al. 2014).

Rural India accounts for more than 35% of the total FMCG market. Total rural income which is currently around USD 572 billion is projected to reach USD 1.8 trillion by FY2021. India's rural per capita disposable income is estimated to increase at a CAGR of 4.4% to USD 631 by 2020. The share of non-food expenditure in rural India is also increasing with the rise in income levels (Fig. 5.1).

Rural markets offer the highest growth opportunity in the Indian FMCG industry (Fig. 5.2). More than 80% of the FMCG products posted higher growth in rural markets as compared to urban ones. They also stand to gain from the contribution of better logistics and distribution. The government's focus on rural markets is also encouraging many FMCG companies to expand their rural distribution network and increase product penetration. Rural consumption is one of the most important growth drivers of FMCG industry in India. Rural consumption has increased led by a combination of increasing incomes and higher aspiration levels; there is increased demand for branded products in rural India.

There are certain key external barriers to expanding in rural markets:

1. Inadequate infrastructure (e.g. roads, power, telecom);
2. Limited local distribution channel;
3. Lack of granular information on rural markets;
4. Inadequate access to financing;
5. Cultural and language barriers;
6. Lack of adequate warehousing facility.

Further on an attempt is made at mapping out the various distribution strategies which have been adopted by various firms to reach out to these markets, and they have been classified into two groups, traditional and emerging, with four strategies

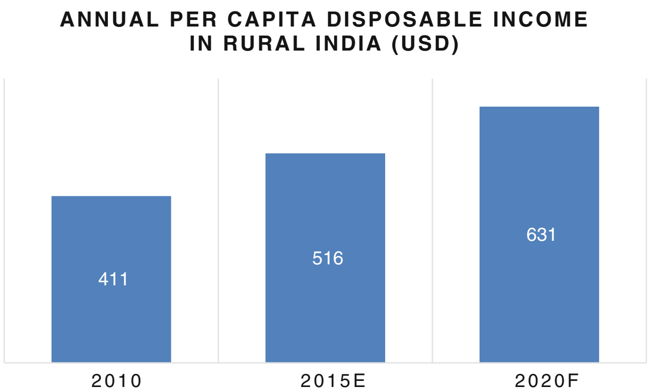

Fig. 5.1 Per capita disposable income in rural India. *Source* https://www.ibef.org/download/FMCG-June-2017.pdf

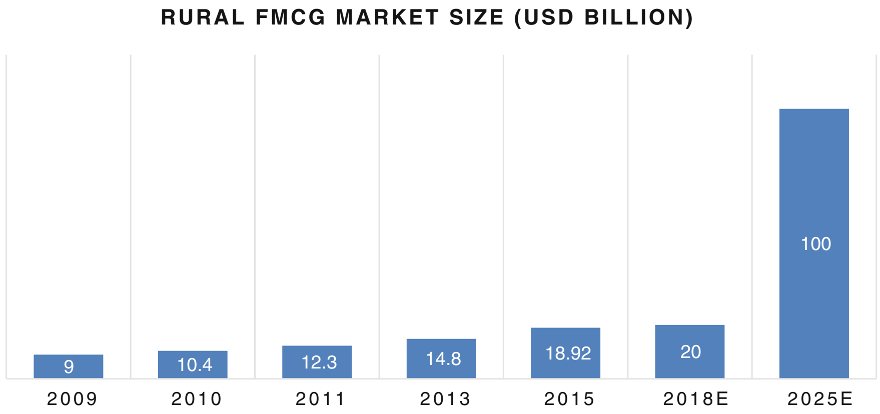

Fig. 5.2 Indian rural FMCG market size. *Source* http://www.ibef.org/industry/indian-rural-market.aspx

described in the first group and two in the later. Each strategy is elaborated with the examples of companies which have either used it earlier or are currently using it. Towards the end, an attempt has been made to compare each of the approaches and come up with recommendations for firms wanting to access rural markets.

Distribution Strategies in Rural India

This section elaborates the various strategies which have been adopted by various companies. Six strategies to reach rural markets have been identified.

Van-Based Model

Van-based model, this the oldest model of reaching out to rural markets. Here the stocks are all loaded in a van, and the van travels to villages and the salesman who accompanies the van takes orders from the small retailers in the village. The stocks are delivered immediately, and then the van moves to the next village after servicing the shops in that village. Some companies also use the vans as a means of communication also. The recent modification of this model has been the use of two-wheelers in the place of vans to reach to villages. Colgate India pioneered this model to sell their toothpaste in villages, and today ITC is also using vans to cover some of their rural markets.

The disadvantage of the model stems from the fact that it can become a very expensive model to sustain, and the amount of business from each visit at times would not cover even the transportation expenses. Though historically it was a very popular means of reaching out to rural markets, today very few firms use it to reach out to rural markets.

Urban Extension Model

The second model is used as the traditional distribution model (urban extension), where the companies use their urban models and add a separate distributor for rural markets. The typical working of the model remains very similar to their urban counterparts. This tends to be subsidy-driven models where the firm has to compensate the distributor for the additional expense of servicing the markets. This model is also very popular with companies like HUL and Dabur India using it to reach to rural India. This has met with limited success as the markets tend to very diverse in nature and the model which works in one part of the country does not work in the other part. The only hope is that with rapidly improving infrastructure the expenses of reaching out to these markets might go down making this mode of distribution more viable. One of the key challenges of this distribution strategy is the difficulty associated with controlling the flow of products from rural to urban markets. This becomes more apparent in companies which pay a differential margin for their distributors based in rural areas.

Wholesaler-Driven Model

The third model is the wholesaler-driven model. In this model, the company reaches out to various wholesalers based out smaller town markets where the rural retailers buy the products they sell. And these wholesalers are mostly located in the small town which has a better accessibility than the villages, and for many companies reaching out to these wholesalers could be a better strategy than trying to reach out to the villages directly. But this reach will come at the cost of loss of channel control, because the wholesalers may be able to sell to rural retailers, but they might do it on their term.

There are many advocates of this model, as Kashyap (2012a) says that six lakh villages in the country need not be reached directly, they could be reached by servicing only about 13% or only 84,000 villages, and it is in these villages where the most affluent of the rural population stays. Aithal (2012), in his study of rural retailers, found that 70% of them regularly bought from the wholesaler in the nearest small town.

This model is also many times not by choice or design but because of the demand for the products in rural markets. And this can be a viable model for many firms which are not willing or capable of investing in setting up channels of their own to reach the rural markets. For many smaller firms, it has become a default option for distribution as this tends to be the least expensive way of expanding.

Procter and Gamble have consciously taken the wholesaler-driven model to distribute into rural India.

Hub-and-Spoke Model

The fourth model is the hub-and-spoke model, which has gained popularity in the recent years. Here the company sets up a set of hub-and-spokes in the rural markets that they would want to serve. The Hubs tend to be directly serviced by the company and the hub services the spoke which in turn services the nearby 8–10 villages. Normally, the hubs would be located either in the nearest small town or a bigger village. This model has the advantage of spreading the cost of servicing the far-flung villages easier. This model is also called the super-stockiest model of distribution. HUL has experimented with this model with limited success. Coca-Cola India has executed this strategy with fair amount of success.

One of the challenges which companies have to face is in the execution of the model wherein the spoke may not be willing to travel and service the rural retailers as envisaged in the design. And if the retailers themselves have to travel to the spoke to buy, then it becomes the wholesaler-driven model because the spoke starts acting as a wholesaler. These four models described above were the older traditional ones. Next two are the models which have been experimented are the merging ones starting with the entrepreneur-based model.

Entrepreneur-Based Model

The entrepreneur-based model is the new addition to this list of options which firms would have when they plan to access rural markets. In the entrepreneur-based model, the companies start by setting up entrepreneurs in a village who in turn acts as a distributor for the firm for the village that he or she is based out of and some nearby villages. Once set-up this channel can be long-term advantage for the firm wanting to access these markets. The most documented and spoken about are the Shakti entrepreneurs' model pioneered by Hindustan Unilever Limited for distributing their products in far-flung rural areas of the country. The strategy consists of using a radically decentralized, door-to-door sales force for selling personal care products, such as soaps, lotions, and detergent, with sales force drawn from members of thousands of small women's savings and loans groups (also known as "self-help groups") (Simanis and Hart 2009).

The model has been tweaked and adopted by Colgate India. They have hired local youth from different sources including Nehru Yuva Kendra Sangathan as their last mile channel partners (Mathew and Mookerjee 2008). The youth is linked to the nearest company stockist and buys stock on cash and sells them to a cluster of 20–30 villages within a ten-kilometre radius carrying stocks on their bicycles.

The drawback of this model is that this tends to a very slow to expand and needs to be customized according to local conditions. This also has the issue of scalability which constraints rapid expansion, which is because of the handholding which many of these entrepreneurs need in the initial years.

Collaborative Distribution Model

The last model is the collaborative model of distribution in rural areas. One of the constraints of direct distribution in rural India is the cost associated with it. Very few companies in India have a portfolio large enough to get profitable business from these markets on their own. This is where the collaborative model of distribution comes in. Within the collaborative model, there are two variants. One is the alliance based model, wherein competing companies come together to service the rural retailers and have a cost-sharing mechanism. This model is about aggregation of demand and servicing the retailers with products from competing firms. This model will have a higher chance of profitability versus the stand-alone models, but will need competing companies to collaborate to service rural markets (Bhakshi 2010).

The second one variant is where a third-party provides infrastructure or a platform to reach rural markets. There would a charge to be paid for accessing villages. This model is still in an experimental stage with a few companies trying it out. As of now companies like Sahaj e-Village limited have started trials of this model, where they are letting other companies use their existing infrastructure of village-based kiosks for distribution into villages. They see themselves as a platform provider which could be utilized by any business which wants to access rural markets.

Concluding Remarks

Though there are many ways of reaching out to rural markets, each strategy has its own share of pros and cons. This section is devoted to understanding the suitability of each model and the challenges associated with the same. The model effectiveness changes with the size of the portfolio size and the expected channel control. Table 5.1 elaborates each strategy and the challenges associated with each strategy. Reality also is that most of the companies do not use a single model, but use more than one at a time to suit their distribution objectives.

And then there is a developmental angle to reaching the rural populations, as has been identified by Vachani and Smith (2008), who in their work on socially responsible distribution, say that reinventing distribution channels is a creative market-based alternative to increasing access through innovation by identifying different routes to reach rural consumers. Periodic markets are nerve centres of rural

Table 5.1 Strategy adopted and suitability

Strategy	Suited for	Pros	Cons
Van-based	Companies with larger product portfolios and higher turnover	High control over the channel Can be rolled-out immediately	High cost-to-serve
Urban extension/ super-stockist	Companies wanting to expand into rural for first time and with low stakes in rural business	Simple to execute Cost can be controlled better	Requires additional investment from existing network
Wholesaler-driven model	Smaller companies with limited turnover and portfolio Least management time and effort Might suit some markets	Can also be among the least expensive Does not require creation of new distribution channels	Least control and difficult to move out of the arrangement and build own network
Hub-and-spoke	Companies with larger product portfolios and higher turnover	Better penetration and control Flexible option for channel structure	But can take time to expand Requires additional investment
Entrepreneur-driven distribution	Companies willing to wait and invest in rural markets	Gives deepest possible reach Can work as long-term channel partner	Long gestation period and handholding needed High level of micro-management Can be expensive to begin with
Collaborative model	Should suit smaller firms which find it difficult to achieve economies of scale	Requires low investment as fixed cost can be shared	Companies should agree to come together, or there has to an external third-party which would be willing to do Focus gets diluted

Source Prepared by Authors

marketing system in India (Kashyap 2012b). They provide a good alternative to reach the interior rural areas as the cost of reaching the outlets in rural areas is higher because of geographical spread. Marketing companies have experimented periodic markets as a distribution channel to reach out to rural dwellers (Velayudhan 2014). Moreover, not many companies followed this alternate channel to get access to the rural hinterlands. Hence, periodic markets can be further used as an additional channel to reach rural consumers (Satyam et al. 2017). Companies need to pay special attention while designing channel for rural markets and ensure availability at local retail store as well as periodic markets (Velayudhan 2014).

Companies have to continue working on distribution level innovation to overcome the myriad of challenges posed by rural markets in India. Multinationals very often adopt the existing strategies from the developed world and fail miserably in emerging markets. They have to offer a distinct value proposition to rural markets across emerging economies. They have to further strengthen the customer retention efforts by providing reliable and consistent after-sales service to succeed in these markets. Companies need to keep innovating as a dedicated after-sales service network for a small number of customers due to geographic spread drives high sales service cost. Success in rural emerging markets primarily depends on the performance of companies on the key parameter of rural-focused innovation. Companies need to help develop these markets, co-creating value for all stakeholders, rather than just capture the existing markets by creating basic infrastructure, and making more investments in rural markets. In return, they can get access to the rural households. Better trustworthiness leads to better sales.

Distribution in rural India has remained a challenge for many years, and companies have tried experimenting with various approaches. The study here identified six different strategies for reaching out to rural markets. Many of these models have evolved over the years. The pros and cons of each approach are discussed. Even today there is no one ideal model which is suitable to the needs of the rural markets. Companies with serious interests in rural should keep innovating and trying out new ways and means of distributing their products.

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