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STRATEGIC MANAGEMENT FOR WHOLESALERS: AN ENVIRONMENTAL MANAGEMENT PERSPECTIVE

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by

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ABSTRACT

The purpose of this paper is to propose that environmental management, a conceptual framework from the organizational policy and strategy literature, can function as a useful paradigm for wholesalers who desire to adopt a long-range planning perspective. This perspective, often called strategic management, may be critical to the success and survival of firms in the 1980's as economic, political, competitive, regulatory, and societal forces exert increasing impact on their performance levels.
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Introduction

Both corporate managers and academicians emphasize the contribution of strategic planning to achieving organizational goals and objectives. Strategic management (Kotler 1979, Schendel and Hofer 1979) may well become indispensable to the success and survival of firms in the 1980's as economic, political, competitive, regulatory, and societal forces exert increasing impact on their performance levels. Wholesalers, in particular, require a managerial perspective that both recognizes and deals with environmental threats and challenges for they depend to a great extent on outside forces to provide support, absorb outputs, grant concessions, and provide inputs. While strategic planning has been implemented by wholesalers in some industries, the strategic management perspective is not typical of wholesaling organizations, nor of academic studies concerned with wholesaling. Academic studies, which traditionally concentrated on operational aspects (Ballou 1967, Heskett 1962, Mallen 1976), have more recently emphasized marketing strategies (Stephenson 1976, Bater and McCammon 1976), but still retain a tactical perspective rather than a long-term strategic management perspective.

A review of recent wholesaler experience reveals several reasons for concluding that wholesalers would benefit from an increased focus on strategic management. First, wholesalers require more effective strategies for coping with the adverse economic conditions
which prevailed in the 1970's and promise to continue in the 1980's. In the last decade, businesses faced double digit inflation rates, rising energy costs, record interest rates, and major economic recessions. While the cumulative effects of these conditions affect all firms, they are more severe in distribution than in manufacturing because of wholesalers' narrower profit margins. The result has been a steady decline in wholesaler profits since the mid-1950's, with a particularly sharp decline between 1968 and 1974 (Bates and McCammon 1976). Wholesaler's high leverage position, and their declining ability to finance growth through internal means, promise to contribute to greater economic uncertainty in the next decade.

Second, wholesalers in general tend to overemphasize internal cost control to improve profits. Emphasis on costs may lead firms to neglect their revenue-generating potential, and also may result in unhealthy streamlining of functions. A study of wholesalers in the medical supply industry revealed overall profits to be strongly related to changes in gross margins, which are largely a function of external forces such as customer purchasing behavior, supplier relations, and competition with other wholesalers (Stephenson 1976). Therefore, substantial profit gains in the industry may require less emphasis on costs and more emphasis on managing external forces.

A final reason for adopting a strategic management perspective concerns the high dependency position of wholesalers in most channels of distribution. Though once very powerful as a consequence of their central location in the channel, wholesalers are now more typically dependent on large manufacturers and retailers.
Large customers can dictate the service mix and operating procedures of the wholesaler, and are able to obtain lower prices, because of their dominant power positions. Manufacturers and retailers may also engage in direct sales negotiations, eliminating the wholesalers altogether or reducing his role to provider of physical distribution. Points of dependency are managed by manufacturers and retailers though their choice of product/market strategy, technology, and physical location (Thompson 1967). Wholesalers, too, can manage their dependency but this approach requires a perspective which first recognizes the dependence and then actively seeks strategies to alleviate or handle it.

PURPOSE

The major purpose of this paper is to propose that "environmental management", a conceptual framework from the organizational policy and strategy literature, can function as a useful paradigm for wholesalers in choosing long-range marketing strategy. Essentially, environmental management is a general term describing a management orientation in which the organization attempts to proactively modify existing environmental conditions. Of particular interest to the wholesaler sector is the notion that dependency on external forces in the firm's environment can be managed through the focal firm's interaction with its environment.

In addition to explicating the general concept of environmental management, we will describe a number of specific strategies for modifying the firm's dependency on its environment. These strategies, discussed by Galbraith (1977) as manufacturer options, are already
being used successfully by wholesalers in some industries. However, these forms of strategic management are not typical of wholesalers.

The Organization and Its Environment

The systems concept holds that organizations are open systems engaging in transactions with their environments (Barnard 1939). The traditional view contends that the environment is the controlling force, but that the organization can respond and adapt to its environment (Burns and Stalker 1961, Lawrence and Lorsch 1967, Duncan 1972), thereby improving its performance.

While acknowledging that a firm's adjustment to external forces will affect its performance, environmental management argues that the organization can also proactively affect its environment. Just as the environment exercises constraints on the firm's decisions (e.g., with respect to strategy-making, goal-setting, and resource-allocation), the focal firm can affect similar decisions of the organizations in its task environment. This influence arises from the mutual interdependence between organizations to provide inputs, absorb outputs, and grant concessions.

Galbraith (1977) noted three general responses corresponding to progressively increasing levels of environmental dependency: (1) **independent strategies**, where the organization attempts to reduce the dependence and uncertainty that threatens its performance by drawing on its existing resources. (2) **cooperative strategies**, in which the firm explicitly or implicitly cooperates with other elements of its environment; and (3) **strategic maneuvering**, designed to change the structure of the competitive environment of the focal organization.
With independent strategies, the firm attempts to retain as much maneuverability as possible by concentrating on developing its own unique independent capabilities. As firms find themselves in an increasingly less powerful positions in their channels (usually accompanied by lower performance levels), they are likely to switch to a cooperative strategy. Finally, a firm may attempt strategic maneuvering, designed to reduce exposure to an unhealthy situation when environmental forces are perceived to threaten its very existence. These three general strategies may take a variety of forms as shown in Table 1.

Independent Strategies

Independent strategies are executed autonomously, allowing environmental forces only indirect influence on the focal organization's decision-making process. The success of these strategies depends both on the firm's ability to implement them more effectively than competing firms and on the potential for demand in these channels to grow sufficiently to support expansion. Reliance on independent strategies is most appropriate in environments characterized by moderate levels of uncertainty and dependency, i.e., in situations where the organization does not rely heavily on the output of a few suppliers or on sales to a limited number of customers.

Competitive Response

Wholesalers tend to be privately held and small in size, to cover limited geographic trading areas, and to exhibit low concentration of sales on a national level (Bucklin 1972). This industry structure typifies the situation where support capacity is dispersed, the situation
where competitive response is most appropriate (Galbraith 1977). Equally important in explaining the wholesalers' use of competitive responses is their tendency to organize through proprietorships, partnerships, or closely held corporations. Beckman (1949) points out that wholesalers adhere to "time-honored methods" (p. 310). Because family influences are conspicuous, with many key executives and employees having grown up in the business, independent decision making is emphasized.

Among wholesalers, a variety of competitive responses can be observed:

* **Low Price/Low Cost.** A very aggressive strategy, low price/low cost uses the lowest market price as its primary sales generator. In order to offset resulting low gross margins, operating expenses are dramatically reduced and controlled, frequently by reducing services and inventory assortment. Stephenson (1976) noted that wholesalers in the health care industry practice this strategy. Top management is largely responsible for selling activities which concentrate in large hospitals, and intense operations control is achieved by sophisticated computerization. While this strategy is beneficial to the wholesaler because it discourages direct distribution by manufacturers, it is inherently risky because it relies on a single competitive attribute, i.e., price.

* **High Service.** The opposite of the low price strategy involves offering high service levels (e.g. high sales support, maintenance of special low-volume items in inventory, increase speed in order processing operations, or delivery of emergency
or small orders). High service may also involve augmenting traditional services with general management and merchandising assistance to customers. The fundamental objective of this strategy is to compete effectively in segments of the market that are not price sensitive.

* **Geographic Concentration.** Wholesalers usually span limited trading areas, and cultivate intensely the total business within that area. The rational for this concentration involves savings in freight charges. Its successful execution over time requires intensive selling efforts designed to maintain or increase purchases from the limited number of customers. To accomplish greater penetration, the wholesaler will engage in strategies such as: (1) establishing a high quality salesforce capable of creative selling; (2) increasing services offered by the salesforce while decreasing the number of accounts per salesman; and (3) diversifying inventories to position the firm as a single source supplier to their customers.

* **Product and Market Specialization.** Rather than concentrate on a geographic market, this strategy involves focusing on a group of product lines. Competitive advantage is established by carrying a broader assortment of products within these product lines, and by providing higher service levels in delivery and technical support. In order to generate the necessary volume to support higher service levels, multiple warehouses are frequently operated.
Cooperative Strategies

When other channel members become powerful (e.g., as a result of increased size), the focal organization may choose to increase its power by aligning itself with other organizations. These cooperative strategies are "coordinated actions of two or more organizations to resolve joint problems" (Galbraith 1977). Execution by specific wholesalers will vary in terms of their scope, the type of establishment included in the process, and the extent of their reliance on agreements to generate revenues and profits. When a wholesaler engages in a cooperative strategy, it is usually because an interdependence exists between itself and other channel members.

Contracting

Contracting involves an explicit form of cooperation in which two or more organizations agree to exchange goods, services, or information, over a specified period of time. In general, an environment of greater dependence and uncertainty leads a firm to use contracting strategies; only then will it be willing to relinquish some of its decision-making ability. Although contracts tend to be initiated by the organization with the greatest immediate need for the goods, services, or information, benefits must be present for both parties. Within the channel of distribution structure, the wholesaler may engage in a variety of contractual relations.

* Customer contracts. Contracts with customers result from a growing realization that wholesalers' welfare is directly tied to customer welfare. Voluntary group programs appeared first in the grocery industry, where rapid growth in chain stores after World War I threatened the viability of the independent
wholesalers. In the voluntary program, the customer agrees to buy almost exclusively from one wholesaler. The success of the alignment depends on the ability of each channel member to aid the other in meeting a common threat. In the grocery industry, the wholesaler helps his customers compete with the chains by providing promotional, merchandising and operating management assistance, as well as a competitive assortment of merchandise. In return, the retailer reduces the wholesaler's operating expenses and uncertainty. In the 1970's the voluntary movement spread to the drug, hardware, automotive, automatic vending, and variety store industries. (Bates and McCammon 1975).

* Manufacturer contracts. Manufacturer-wholesaler contracts exist in almost all product lines except raw materials. They rarely occur with products distributed widely at retail. As is the case with the customer contract, the basis for initiating the manufacturer contract is mutual interdependence. The manufacturer obtains exceptional local sales support which the wholesaler is willing to provide, especially when margins are tight because of intense local competition. The wholesaler, in return, is guaranteed a source of supply and reduction in uncertainty.

Implicit Cooperation.

Implicit cooperation involves patterned and predictable behavior that occurs without explicit effort at coordination between competing organizations. In manufacturing, the most common example of this behavior is price leadership, where firms look to one organization to initiate price change with the implicit agreement that all firms will follow suit.
Price leadership is impractical among most wholesalers because of the size of their product mixes. However, a number of other avenues by which these wholesalers can typically cooperate to reduce uncertainty include:

* **Freight Charges.** The incidence and amount of freight charges within industries are generally uniform. As an example, 80 percent of the wholesalers in the medical supply industry charge for freight and exhibit little difference in the amount collected as a percent of sales (Stephenson and Cron 1981).

* **Credit Terms.** The terms for cash discounts and late payment charges tend to be consistent within an industry (except for cash-and-carry wholesalers). This again indicates unwillingness to compete on the basis of price and/or physical distribution service.

While the extent of cooperation on these issues may not be as obvious as price leadership, wholesalers are likely to look toward the dominant firm to initiate change.

**Coalition**

The final form of interorganizational cooperation is coalition, i.e., two or more firms acting jointly with respect to an issue over a period of time. Coalition goes beyond contracting (which involves merely an exchange between firms) by making a commitment to joint decision-making by firms at the same level in the distribution channel. Galbraith (1977) noted that this strategy prevails when the environment is highly turbulent, thereby threatening the performance levels of firms.
* Trade Associations. National and regional trade associations have existed among wholesalers for a long time. Associations take an active role in helping independent firms to operate more efficiently and in analyzing their markets. The American Surgical Trade Association, for example, sponsors frequent surveys and seminars designed to help its membership conduct business. Equally important, the association has assumed an active role in representing small independent wholesaler on legal issues, as well as educating manufacturers regarding the needs and benefits of member wholesalers.

Strategic Maneuvering

The third approach to environmental management, strategic maneuvering, is a direct attempt to alter the competitive structure of the industry. This strategy produces significant changes in both the firm's environment and its internal organization; therefore, it is most appropriate when dependence and turbulence is severe enough to justify the accompanying risks involved.

Mergers.

Mergers combine two existing companies, allowing joint decision-making to occur under a single hierarchy of authority. Mergers in wholesaling do not occur frequently.

* Horizontal. Independent wholesalers merge infrequently. Federal antitrust agencies are rarely concerned with horizontal mergers of wholesalers, since most involve companies operating in different market areas. Consequently, no increase of local concentration ratios results. The absence of mergers is partially a function of the limited financial resources of privately-owned wholesalers, as well as inherent difficulties in controlling
operations at multiple locations. However, increased customer concentration may override these disadvantages in the future.

* Vertical. While the extent of manufacturer-wholesaler mergers has not been great, the federal agencies have been much more active in this area. Several complaints have been filed in the dental supply, optical supply, and paper industries, where vertical integration has increased sharply.

Diversification

Diversification is a strategy actively pursued by wholesalers in a variety of industries, partially because of the large number of forms it can assume. In addition, the same physical plant can be used to inventory widely divergent product lines and assembly processes. Bucklin (1972) noted the preponderance of intertype competition in the food, drug and gasoline industries.

Bates and McCammon (1975) noted some of the more successful forms of diversification in wholesaling to include:

* Inventory diversification. This involves the addition of product lines designed to increase sales and strengthen customer relations. The strategy is often combined with that of geographic specialization.

* Wholesale diversification. Out of multiple locations, the firm tries to operate separate multiple businesses. The strategy has produced mixed results because of the complicated problems of managing multiple businesses.

* Retail diversification. The main incentive is to gain greater control over demand and to take advantage of the higher gross
margins possible at retail. However, operating expenses may also increase (Cron and Stephenson 1980).

* Manufacturing diversification. Manufacturing diversification represents one of the most popular strategies with an increasing number of firms evolving into self-supply networks. American Hospital Supply Corporation illustrates this strategy, especially in its ability to divert of sales from other manufacturers to its own private labels.

SUMMARY

Several environmental management strategies have been used successfully by wholesalers in a variety of channels. However, present environmental threats to the continued high performance of wholesalers suggests that greater attention should be directed to the formulating of successful wholesaler strategies. To aid wholesalers in analyzing their environments and in formulating successful strategies, the environmental management perspective is proferred as an effective approach and as a means for organizing strategies historically used by wholesalers.
Table 1:

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<th>INDEPENDENT STRATEGIES</th>
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<td>o Customer Specialization</td>
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<th>COOPERATIVE STRATEGIES</th>
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<td></td>
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<td><strong>B. Implicit Cooperation</strong></td>
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<td><strong>C. Coalition</strong></td>
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