Strategic Actions of Wholesaling Firms: A study based on the strategic group concept

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[Abstract]

The studies on the innovation in types of operation have hardly been done in the field of wholesaling distribution. There are classifications by types of operation such as specific wholesale and general wholesale, full function wholesale and limited function wholesale, and the primary and secondary wholesale. But, it is difficult to explain the change of competitive structure in the modern wholesaling distribution and the innovation actions of wholesaling firms by using such classification. Therefore, this paper proposes the strategic group concept as a way to analyze the innovation in types of operation for wholesaling distribution and considers the competitive structure and the innovative actions in the modern wholesaling distribution based on the strategic group concept.

[Key word]

wholesaling distribution, types of operation, strategic group

I. Awareness of the issue

The studies on types of operation have long been conducted by many global researchers in the field of retailing. Researchers have classified retailing firms which have various activities by the standard of retailing mix and analyzed the relationship between the emergence of new groups and the market share. In regard to the theory on types of operation for retailing, some theoretical problems have been pointed out (Kato 1998, Takashima 2002 b). But, it should be highly evaluated that the theory has promoted more studies about the change in competitive structure of retailing and the innovative process of retailing firms(1), thereby making it easier to understand types of operation for retailing.

In this way, the studies on types of operation have been actively done in the field of retailing. Meanwhile, the fact is that the studies on types of operation related to innovative process have hardly been done in the field of wholesaling, which is one of the distribution institutions like retailing.

As the existing studies on types of operation for wholesaling, three types of classifications can be cited: the classification by the feature of product structure
such as specific wholesale and general wholesale, the classification by the function such as full function wholesale and limited function wholesale and the classification by the relation to a manufacturer such as the primary wholesale, the secondary wholesale and special agent wholesale. But, those studies only deal with classifying wholesaling firms.

There are few studies which deal with the innovation and change in competitive structure for wholesaling firms. The reasons are as follows: first, it is difficult to set a standard to classify types of operation for wholesaling like the standard of retailing mix; secondly, wholesaler innovation has not been dynamically done.

However, as Kim(2005,2008) noted, consumer goods wholesalers have mainly introduced a various types of process innovation, which have never been seen before. These types of process innovation for wholesaling firms are not passively developed at the request of customers; rather, wholesaling firms tend to take the lead in ensuring competitive advantage and efficiently using physical distribution system. Thus, they are different from the conventional types of process innovation.

Under the current circumstances of the studies, a theoretical framework should be provided to explain the ongoing change of competitive structure for wholesalers and the mechanism of innovation. But, it is too difficult to analyze them by the same standard as that of retailing because there is difference between retailing and wholesaling in surrounding situation and occurring phenomena. Therefore, a new perspective should be introduced.

We should think about introducing the strategic group concept in wholesaling as a way to solve the above problem. By introducing the strategic group concept, we can not only easily understand the competitive structure for wholesalers but also classify strategic actions of wholesaling firms as a certain type. Specifically, that can provide answers to the questions of why and how strategic actions of wholesaling firms are conducted. Furthermore, it is expected that will make it easier to explain the phenomenon of new wholesaling firms emerging as well as the process which will clear mobility barriers, such as movement to another strategic group and formation of new groups. Through the procedure, we can get a clue to develop theory in studying types of operation for wholesaling.

II. Basic dimensions on wholesaling firms' strategies and strategic groups

The important thing in strategic group analysis is, as Porter (1980) said, to take out an strategic axis which can best represent competitive structure of a given industry. In this paper, strategic groups are taken out after basic dimensions on wholesaling firms’ strategies are considered.

1. Basic dimensions on wholesaling firms’ strategies

What can be thought of as basic dimensions to classify wholesaling firms' strategies?
Porter (1980) proposed product line and vertical integration degree as axes to classify strategic groups of manufacturers. But, these axes target manufacturing industries and it is difficult to apply them to the industrial analysis of distribution institutions. In this sense, the natures of wholesale distribution and wholesaling should be taken into account: that is, we should consider the distribution level characteristics of a wholesaler as an intermediate between manufacturers and retailers and the industrial nature of a food wholesaler. They are explained in further detail in the following section.

1–1. Viewed from the characteristics at the distribution level

The characteristics of a wholesaling firm as an intermediate at the distribution level could make suppliers and retailers pressure factors of competition as well as bases of growth.

First, regarding suppliers and retailers as bases of growth, if a wholesaling firm serves as a distribution institution which is expected by clientele, that will bring it chances to grow. For example, if a wholesaling firm builds exclusive and coordinative relationships with manufacturers with strong brand products or if it forms coordinative business connections with growing retailing firms, the wholesaling firm involved will reap the benefit in sales and market share.

Secondly, suppliers and retailers as potential pressure factors of competition mean that negotiation ability is more likely to be a major pressure factor of competition.

Porter (1985) cited as pressure factors the new entry and the threat of alternative goods in his competitive pressure theory. But the negotiation ability shown as a seller or a buyer is more likely to be a major pressure factor of competition than the things cited by Porter. It is predicted that this factor will affect wholesaling firms' profitability rate because the factor will pose an issue of profit sharing with clientele.

In this way, the relationships with strong clientele can lead to pressure factors of competition as well as bases of growth, bringing wholesaling firms the issue of putting a squeeze on costs. Thus, in analyzing wholesaling firms from the viewpoint of distribution level, business relationships with clientele and change in the relationships should be mainly considered.

1–2. Viewed from the characteristics of the dealing environment for consumer goods wholesaling firms

As for factors which could influence actions of consumer goods wholesaling firms, we can cite change in channel policy of manufacturers, advanced information and physical distribution technology, intensified competition within wholesalers and emergence of large-scale retailing firms. This paper pays attention to emergence of large-scale retailing firms. That is because the emergence of large-scale retailing firms is responsible for reshuf-
filing of distribution structure.\(^6\) This is specifically discussed below, referring to Figure 1.

![Figure 1. major transaction environments which affect wholesaling firms' action](image)

First, the emergence of large-scale retailing firms promotes the polarization in retailing and this situation forces small and medium retailing firms to be on the decline. The situation poses a managerial problem of customers’ decline for some wholesalers(Channel ③).

Secondly, manufactures become acutely conscious of the power relations with retailers due to emerging large-scale retailing firms. It can lead to changes in the manufacturers’ channel policy such as integration of special agencies and outlets (Takashima 1994, Ozaki 1998). In addition, if a manufacturer aims at efficiency in dealing, it could prefer a direct dealing with a large-scale retailing firm. A wholesaler is faced with new managerial environments due to these two aspects. Needless to say, the change on the part of manufacturer is attributed to the pressure of a large-scale retailing firm. In Figure 1, ② act in the background of Channel ②.

These two aspects (Channel ① and Channel ②) act to intensify competition within a wholesaling industry.

A large-scale wholesaling firm could introduce an innovative system for dealing with retailing firms which operate a store chain in order to overcome the severe competitive environments(Kim 2008).

Thus, in the case of consumer goods wholesaling firms, the issues coming from emerging large-scale retailing firms and the business relationships with the large-scale retailing firms are extremely significant as potential factors which will affect wholesaling firms.

As described above, the factors to examine in analyzing consumer goods wholesalers are considered in terms of distribution level and consumer goods wholesalers’ nature. This consideration suggests that in analyzing consumer goods wholesalers, the relationships with retailing firms, particularly with large-scale retailing firms are important. In the following paragraphs, the relationship between a wholesaling firm and a large-scale retailing firm is considered.

1-3. Derivation of strategic axes

The discussion above indicates that in analyzing consumer goods wholesaling firms, using the relationship with a large-scale retailing firm as an analyzing axis is effective. Considering current strategic actions of wholesaling firms, elements related to these actions can be frequent delivery, introduction of information system,
introduction of physical distribution system and construction of a physical distribution facility which is exclusively used for a specific retailing firm. These elements are involved in the relationships with large-scale retailing firms.

However, setting a strategic axis at these concrete action levels does not serve this paper's purpose of analyzing wholesalers' strategic actions by means of strategic group concept. That is because structure variable is more suitable than action variable for expressing the relationship between a wholesaling firm and a retailing firm. In addition, preferably, the variable should steadily represent wholesaling firms' actions(7).

Thus, the sale dependence on large-scale retailing firms can be thought as a variable. This variable was proposed by Ishihara in the theory (1982) on the power relation, which is one of the theories to explain relations between firms. Ishihara noted that the power dependence model is unconvincing as it does not include structure variable and insisted on the necessity for the concept of transaction dependence degree.

There are the following advantages in introducing the concept of sale dependence into this paper. First, the ratio of large-scale retailing firms as sale destinations can be easily explained numerically through research. The numerical values show how much a wholesaling firm puts an importance on building and keeping business relationships with large-scale retailing firms as sale destinations. Secondly, the numerical values can tell us whether wholesaling firms seek to alter the business relationships. That is because wholesaling firms with a high ratio of sales to large-scale retailing firms, as Takashima pointed out (1996), could make a certain strategic action on their business relationships to solve the issue of profit sharing caused by the power relation.

We have examined that the sale dependence on large-scale retailing firms can be an axis to analyze consumer goods wholesale industry in terms of both their relationships with large-scale retailing firms and their strategic action. But, as dealings with large-scale retailing firms are accompanied by the issue of profit sharing with them, wholesaling firms' ability to alter the business relationships is needed.

The discussion as to altering the business relationships with large-scale retailing firms is based on the assumption that wholesaling firms have already built the relationships, hence in order to build the relationships, the high managerial ability of wholesaling firms is asked. That is because large-scale retailing firms want to, for efficiency, deal with wholesaling firms which can handle frequent and small-lot delivery in a larger area. Wholesaling firms need advanced physical distribution processing ability to meet the needs of large-scale retailing firms and major investments are necessary to ensure this ability.

In this way, the abilities of wholesaling firms are needed to build business relationships with large-scale retailing firms.
### Figure 2: Concept Axes of Strategy

#### Analysis and Discussion

The concept axes of strategy are illustrated in Figure 2, which shows the relationships between the size of wholesaling firms and their dependence on large-scale retailing firms. The axes are divided into four quadrants (T1, T2, T3, T4), each representing different combinations of size and dependence levels.

- **T1**: Large firms with low dependence on large-scale retailing firms.
- **T2**: Medium-sized firms with low dependence on large-scale retailing firms.
- **T3**: Medium-sized firms with high dependence on large-scale retailing firms.
- **T4**: Large firms with high dependence on large-scale retailing firms.

#### Strategic Implications

- **T1** firms can focus on niche markets and specialized services, reducing reliance on large-scale retailing.
- **T2** firms can maintain a balance between size and market reach, offering a moderate level of service.
- **T3** firms are well-positioned to leverage their size and dependencies, potentially offering economies of scale.
- **T4** firms must manage high market dependencies carefully to sustain their market presence.

By understanding their positioning in these quadrants, firms can strategize accordingly to enhance their competitiveness and market positioning.
aim at efficient management. In this sense, they can serve as voluntary chain headquarters among these four types of groups.

Group IV (T4) consists of wholesaling firms where there is much amount of sales to large-scale retailing firms, but there is tendency to be at their main customer's disposal. This group can be called retailer-dependent type.

III. Strategic groups and innovative action

In the previous section, we find axes to analyze strategic actions of wholesaling firms in the food wholesaling and classify strategic groups, using the axes. In this section, the details of strategic actions of respective groups are discussed. By doing that, we attempt to find a clue to explain the background and mechanism of wholesaling firms' strategic actions.

1. Strategic actions which are different according to strategic groups

Type I (T1) Conventional Type

Most of Type I wholesaling firms perform a wholesaling function under the manufacturers' channel policy and are more likely to be close to their region. The decreasing number of customers could result in reduced profits. To solve this problem, these wholesaling firms could try to use regional information and improve their service. Even if they introduce innovative information system within a firm, they may not conduct it actively. That is because their firm size is small and investment in introducing the system is often restricted. Also, small and medium retailing firms which are removed by Type II and IV wholesaling firms are more likely to be their customers. Their profitability rate could be the lowest among those for the four types of groups.

Type II (T2) Retailer-oriented Type

Type II wholesaling firms perform a physical distribution function which is needed by large-scale retailing firms, thereby building close relationships with large-scale retailing firms. These wholesaling firms, to perform a physical distribution function, heavily invest in introducing information system such as participation in the information network between firms and in introducing physical distribution system of constructing a physical distribution center to improve procurement ability. On the part or retailing firms, there are a number of advantages to utilizing the physical distribution systems. Thus, the transaction dependence increases for both Type II wholesaling firms and large-scale retailing firms. However, increased dependence on a specific retailing firm could pose an issue of profit sharing such as low revenue and instability nature.

So, the wholesaling firms need a new strategy to solve the issue posed by the relationship with a specific retailing firm. First of all, they need wide-area and full-line operations which can create the economic effect such as "Economies of scale" and "Economies of scope" (Kim 2005). Because integrating other wholesaling firms
is the most efficient way to promote wide-area and full-line operations, Type II wholesaling firms are likely to aggressively integrate other wholesaling firms.

In addition, Type II wholesaling firms may enhance a product planning function and strategically develop private brand products. Also, targeting midsize retailing firms, they may offer high-level retail support based on advanced information and physical distribution processing ability. These efforts enable the wholesaling firms to reinforce their business relationships with midsize retailing firms and to adjust their transaction dependence with large-scale retailing firms.

In this way, the wholesaling firms may perform a physical distribution function for large-scale retailing firms and may perform a product planning function and offer retail support for midsize retailing firms. Thus, it is predicted that Type II wholesaling firms will gain the largest share among the four types. Yet, even if Type II wholesaling firms retain their share, they will not necessarily increase their management results along with retained share. That is because the following issues put the squeeze on cost: a cost issue of investment in innovative system, a cost issue of maintenance and an issue of profit sharing caused by the business relationships with retailing firms.

Furthermore, building the business relationships between Type II wholesaling firms and strong retailing firms is based upon the assumption that the wholesaling firms possess assets specially linked to business relationship: information system and physical distribution system. Thus, the business relationships tend to be very close. Such close relationships are not easy for the wholesaling firms classified as other strategic groups to emulate, and play an important role as resources to maintain competitive advantage and as mobility barriers.

Type III (T3) Voluntary chain headquarters

As for Type III wholesaling firms, their large firm size and high investment ability should enable them to introduce innovative system and build close relationships with large-scale retailing firms. Despite that, Type III wholesaling firms do not positively attempt to build such relationships. But, instead, they raise the rate of profitability by exploiting the advantage of business relationships with midsize retailing firms. Also, there is a possibility of increasing dealings with small and medium retailing firms which are removed by Type II wholesaling firms.

These wholesaling firms intensely vie with Type II wholesaling firms for midsize retailing firms and wholesaling firms as customers. To solve the problem, Type III wholesaling firms are more likely to build an alliance with other wholesaling firms, aspire to voluntary chain headquarters and try to maintain stable business relationships with many retailing firms: thus they go for a wide-area operation. But, they do not want as wide an operation as Type II wholesaling firms. In addition,
they are likely to aim for a full-line operation which realizes delivery by bulk to serve as voluntary chain headquarters. It is also predicted that they are willing to introduce innovative system in information and physical distribution to serve more efficiently as voluntary chain headquarters.

Type III wholesaling firms gain advantage in transaction dependence, so they are able to maintain high earnings. In this regard, it can be said that Type III wholesaling firms tend to pursue profitability rather than market share, while Type II wholesaling firms tend to pursue share rather than profitability.

Type IV (T4) Retailer-dependent Type

Type IV wholesaling firms heavily depend on large-scale retailing firms. But, excessive dependence places a firm at a disadvantage. In addition, it is predicted that due to small and medium firm size and less willingness and low ability to invest, large-scale retailing firms which expect wholesaling firms to perform a physical distribution function tend to decrease dealings. To avoid the situation of decreased dealings, the wholesaling firms are more likely to increase dealings with midsize retailing firms.

Yet, to increase dealings with midsize retailing firms, the wholesaling firms need to introduce innovative information system such as participation in information network between firms. Therefore, it is predicted that Type IV wholesaling firms attempt to utilize small resources efficiently by investing independently regarding information system and by using joint delivery regarding physical distribution.\(^{(12)}\)

IV. Conclusions

Strategic actions of wholesaling firms have been discussed using strategic group concept. We can consider this classification a useful concept in understanding strategies and new phenomena in wholesaling. Also, the adoption of time concept as an axis of strategic groups could lead to studies on types of operation for wholesaling. If wholesaling firms are classified by operation form rather than type of industry, like the previous sections, and the change in types of operation for wholesaling is examined in historical terms, a new analytical framework can be provided in the field of study on types of operation for wholesaling. However, the classification mentioned above includes the following questions.

First, there is a question whether items which were explored as a theoretical hypothesis can be confirmed by actual data. Unless this question is solved, the proposal in this paper will only be a theoretical hypothesis. Therefore, it is necessary to confirm what is going on in reality, using data. But that will be the future challenge. Also, in verifying it, comparison of track records between groups will be requested, which is an intended purpose of strategic group theory.

Secondly, the business relationships with customers are mainly examined in this paper, but the relationships with suppliers should be examined. Even if the re-
relationships with retailing firms are built in selling, a frequent and small-lot delivery system cannot work efficiently without addressing system construction in buying.

In consideration of the above items, further studies will be needed.

**Footnotes**

(1) As for retail innovation, in addition to the analysis by the theory on types of operation which is referred here, there are studies which pay attention to innovativeness in a specific retailing firm such as Seven-Eleven Japan Co., Ltd. (Yasaku 1994, Ogawa 2000)

(2) Ko (1997) and Nishimura (2003) pointed out the possibility of change in types of operation for wholesaling, paying attention to the relation to the retail level. But they did not analyze items about innovative process of wholesaling. Still, in these two studies, an important clue can be seen to analyze the direction of wholesale innovation and the innovation process of wholesaling.

(3) For example, we can cite the innovation carried out at the request of clientele such as introduction of agency system.

(4) Yet, considering strategic groups in wholesaling in this way does not directly mean examining types of operation for wholesaling. To analyze types of operation we should observe that a given group gains the large share through the introduction of innovation. It is difficult to observe such a thing in the current innovation which is seen in wholesaling. Thus, to analyze types of operation, we need historical consideration, focusing on innovation.

(5) As for the new entry, few wholesaling firms newly enter the market in reality. Also, as for the threat of alternative goods, some researchers say that manufacturers and retailing firms tend to perform a wholesale function within their firms and physical distribution firms may perform a wholesale function. But, in actual food wholesaling, those phenomena do not have a crucial impact on the management base of wholesaling firms.

(6) Yahagi (1994) insisted that the upper concentration of retail market is a basic drive which changes distribution channel strategies of suppliers.

(7) Low mobility barriers can be pointed out. Low mobility barriers are more likely to prevent strategic groups from being formed. As low mobility barriers are expected in action and investment, this paper adopts structure variable as an analysis axis to classify strategic groups in analyzing strategically innovative actions of wholesaling firms.

(8) The introduction of innovative system and the advanced functions could influence relationships with large-scale retailing firms, track records and other activities of wholesaling firms. For example, regarding business operations, wholesaling firms are able to convert their operation to a proposal-oriented operation, using operation ability improved by the introduction of physical distribution and the development of private brand products. Also, the introduction of information system enables a wholesaling firm to conduct an information sharing-oriented operation, using the information network system with retailing firms.

(9) Type II wholesaling firms could terminate their business relationships with small and medium retailing firms in order to aim for efficient business. This conduct also means that they intend to focus on specific customers. The business strategy of Ryoshoku Ltd. can be cited as an example. *Kobe Business School Case Series, Vol.9, 2001*.

(10) Detailed description on this can be seen in Williamson (1975).

(11) The typical example of Type II wholesaling
firms is Ryoshoku Ltd, which is referred in the text.

(12) Innovation based on information system is more likely to be carried out in other business activities. For example, a business operation tends to be an information sharing-oriented and full-line operation.

REFERENCES


REFERENCE MATERIALS


