Dakshin Metal Products: Complexities of Channel Management

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Abstract

This teaching case was developed for the students of sales and distribution management, an elective offered to the post graduate students of business management in most of the B-Schools in India. All the characters in this case are fictitious, including the name of the company. The issues dealt with in the present case study are based on my experiences in various organizations that I have worked for. The gap between theory and practice and how lack of grass root knowledge of the market could be a major handicap, even for those who have impeccable credentials, formed the back drop of this case. This case would help students get better insights into various aspects of sales & distribution management.

Keywords : **channel relationships, channel control, channel conflicts, channel power, case study, sales and distribution management**

JEL Classification: D47, L14, L81

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The following were the opening remarks of Mr. Ashwin Chengappa, MD of Dakshin Metal Products in the dealers' conference at Mercara in May 2013 :

> "Friends! Welcome to the 10th Annual Dealer's Conference of Dakshin Metal Products. At the outset, let me introduce Mr. Tanmay Bhowmik, our new GM (Marketing). Tanmay is an MBA from IIM Ahmedabad and has over 7 years of experience in the steel industry. Prior to joining us, he was with Metal Products India Ltd., Indore as the Marketing Manager. I am sure all of you will extend the same support and cooperation to Tanmay that you have been extending all these years to the management of Dakshin Metal Products (DMP)."

Tanmay had taken over as the GM (Marketing) of DMP couple of weeks earlier and was still in the process of acclimatizing himself with the organization. It was a bright sunny morning, and the setting was perfect for the dealers' conference where business and pleasure blended so well that all the dealers eagerly looked forward to this annual event to take a break from their routine and rejuvenate themselves. Mr. Ashwin was well respected by the employees and customers not only for his regality, but also for playing the perfect host.

Company History and Background

DMP was set up in 1999 at Bangalore. Ashwin, hailing from a family of coffee farmers, had been a leading distributor of steel tubes and allied products for over two decades before venturing into manufacturing. The buoyant market conditions, reasonably good profit margin, and his extensive knowledge of the industry prompted Ashwin to integrate backwards. DMP manufactures precision steel tubes required by automobile, general engineering, transformer, furniture, and bicycle manufacturers. Installed capacity of DMP is

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25000MT/annum, and for the past 2 years, the capacity utilization had been close to 90%.

The market for steel tubes is highly fragmented. While all India players like Tube Investments, Tata Steel, Bhushan Steel, and Caparo Steel Tubes [1] cater to major original equipment manufacturers (OEMs), regional players such as DMP and Nezone focus more on the replacement market and small-ticket buyers. DMP's operations are confined to South India, which has a potential of 100000 MT. While 30% of their business comes from OEMs and institutions, the remaining 70% is from micro, small, and medium enterprises (MSMEs) served by a well-established dealer network. Having been a distributor of steel tubes himself for more than two decades, Ashwin had built up an excellent network of contacts with all the OEMs and dealers in South. Even after setting up DMP, Ashwin did not wind up his distribution arm and continues to market the steel tubes manufactured by DMP to retail customers in Karnataka through an outfit called Kavery Steel Traders (KST). However, the day to day management of KST is taken care of by his daughter, Shephalika. With a turnover in excess of ₹ 120 crores and cumulative annual growth of 12%, 4% higher than the industry average, Ashwin wanted to induct professionals to manage the business. He was impressed by Tanmay, who was referred to him by a friend, and appointed him as the GM (Marketing) in April 2013.

Market Structure

TI, the flag ship company of Murugappa Group, is the market leader with annual sales of over 150000 MT of precision steel tubes. The total size of the domestic market is about 500000 MT, out of which South India accounts for 20% of the market share. TI being a Chennai based company has an advantage over others in South. However, its focus is more on OEMs like TVS Motors, Hyundai, Ford, Ashok Leyland, and BHEL . Apart from OEMs, the company also targets auto component manufacturers located in the Chennai-Hosur corridor. They are not very active in the trade (retail) segment, which contributes to less than 20% of their turnover. Other major players, in spite of having a pan - India presence, are more active in their respective regions. This is because of the fact that freight accounts for almost 3% of the selling price, and the gross margins are not more than 7-8% in this industry.

Distribution Network

DMP has dealers in all the major cities in South India. While distribution in Karnataka is taken care of by KST, which has branches in Hubli and Mangalore, seven dealers were appointed in Tamil Nadu and three each in Kerala and Andhra Pradesh. The List of DMP's dealers is appended in the Table 1.

Dealers for steel tubes normally operate on an exclusive basis, though the agreement did not explicitly specify this. However, for special sizes beyond the range of DMP, the dealers have tie ups with TI and other manufacturers. To offer material on demand to dealers and to take advantage of some of the prevailing sales tax regulations, DMP set up depots at Salem, Chennai, Kochi, and Secunderabad. Material is stock transferred to these depots, and local bills are raised on dealers whenever supplies are made from the depots. All the dealers have warehousing facilities and maintain stocks equivalent to 20-30 days' sale. Dealers act both as wholesalers and retailers. Apart from the goods sold across the counter, they also supply material to sub-dealers in the surrounding markets. Apart from catering to small customers directly and through sub-dealers, the dealers also supply material to OEMs on an exceptional basis, for instance, when there are stock outs leading to line stoppage, and small quantities are required for prototypes or field- trials. This, however, is purely a stop-gap arrangement and not a contractual obligation to be discharged by the dealers. The dealers are billed at the list price less trade discount that varies from 5-7%. Incentives such as cash discount and quarterly volume discount (subject to the committed volume being achieved) are passed on to the dealers. Depot in-charges of the company visit the dealers

[1] The companies referred in this case are major manufacturers of precision steel tubes in India and the information pertaining to these companies cited in this case is available in the public domain.

Table 1. List of Dealers

Dealer	Location	Area(s) covered
Sree Murugan Pipe Traders	Coimbatore	Coimbatore,Nilgiris,Erode
Ranganatha Steels	Trichy	Trichy ,Pudukottai,Karaikudi
Kapila Steel Tubes	Chennai	Chennai,Kancheepuram,Thiruvallur
Meenakshi Steel Traders	Madurai	Madurai,Virudhnagar,Tirunalveli
SriKrishna Steel&Hardware	Salem	Salem,Dharmapuri
Sri Ramajayam &Co	Kumbakonam	Tanjore and Kumbakonam
Tamilnadu Steel Suppliers	Maraimalainagar (Peripheral Chennai)	Chengalpat,Villupuram
Pipes&Hardware	Kochi	Central Kerala
Sukumar Steels	Kozhikode	North Kerala
Sri Padmanabha Traders	Thiruvananthapuram	South Kerala,Nagerkoil
Amit Steel Traders	Secunderabad	A.P
Sri Venkateswara Enterprises	Vijayawada	A.P
Raghavendra Pipe Distributors	Kurnool	A.P

at least twice a month. The company also shares local promotion expenses with the dealers such as advertisements in local media, participation in trade shows, and sponsoring of local events. Sign boards, showcases for display of samples, and other point of purchase (POP) display materials are provided by the company to all the dealers. New Year compliments are also made available by the company for distribution among sub-dealers and retail customers.

Thirty days interest free credit is also extended to the dealers. In case payments are made earlier than 30 days, cash discount @18% per annum is allowed on a pro-rata basis. Overdue interest @12% per annum is charged on delayed payments. Freight from factory to depots and from depots to dealers' places is borne by the company. Coolie, cartage, and secondary freight charges are charged to the dealers' account. The terms offered by DMP are generally at par with the competitors. However, it is not uncommon in precision steel tubes industry to offer customized discounts/incentives on a case-to-case basis if the situation warrants such interventions, which DMP's management was fully conscious of.

The Present Scenario

After the annual sales conference, Tanmay undertook an extensive tour of South India. By meeting all the dealers, apart from understanding the local markets, Tanmay wanted to build a personal rapport with the channel partners. In his earlier assignment, the dealings were mostly with OEMs, and managing channel partners was a relatively new and challenging task for him. Though he was not conversant with the local language, communication was not a major issue as all the dealers had working knowledge of Hindi and English. The first quarter (April-June 2013) ended uneventfully, and by July 13, Tanmay was in control of the things. He had a small team comprising of a manager and two marketing executives apart from the field executives managing the depots.

In the quarterly review meeting held in the first week of July, Ashwin urged Tanmay to come out with a revised incentive scheme for the dealers so as to motivate them to perform to their full potential and promote healthy competition among them. He was of the opinion that the dealers and the sales team were slowly slipping into a zone of comfort, and it was time to shake them out of their complacency. Furthermore, Bhushan and Nezone had become quite aggressive lately, and were bent upon improving their volumes to utilize the additional capacity created by them during the last fiscal.

Table 2. Trade Discount

State	Trade Discount	
	Existing	Revised
A.P & Telangana	5%	6%
T.Nadu	6%	7%
Kerala	5%	6%
Karnataka	7%	7%

Note: The above discount is passed on in the bill itself

Table 3. Revised Turn Over Discount

Slab(Offtake/quarter) in MTs	TOD(%)	
	Existing	Revised
<150	2	1.0
151-250	3	2.5
251-400	4	4.0
401-600	5	6.0
601-900	6	7.5
901-1200	7	9.0
1201 &above	8	10.5

Tanmay studied the past sales figures and observed that the July-September quarter had always been lack lustrous for the industry due to monsoon and consequent slowdown in demand. However, sales picked up from October onwards due to the onset of the festive season and this trend continued till March. Any revision in incentive structure that could help sustain the sales in Quarter II (July-Sep) would be a real morale booster for the entire organization. After detailed discussions with his team, Tanmay came out with the revised incentive scheme, salient features of which are described in the Tables 2 and 3. However, he kept all the dealers out of the loop while redesigning the incentive scheme, except Shephalika (KST), as he was afraid that the others might resist any changes made in the existing structure and come up with unreasonable demands, if their views were sought.

Ashwin had a good look at Tanmay's proposal. He observed that the emphasis was more on volume, and those who went for higher volume slabs benefitted a lot if they indeed achieved the volume targets. Though he did not find any major loopholes in Tanmay's proposal, he advised Tanmay to call for a quick dealers' meet and present his proposal in person to the group. His brief to Tanmay was:

> "Tanmay, you are an MBA and have been in the industry for a while. While prima-facie your proposal looks OK, it is important to take our dealers into confidence before we go ahead with its implementation. Let me be kosher with you. The way dealers look at things is very different from what the OEMs do. Don't expect the dealers to be always rational. Some of them are here for reasons other than money. Good luck to you and your team."

A dealers' meeting was called for in the second week of July. While few of the dealers wondered as to what made the management go in for the revised scheme, others chose to remain silent. At the end of the meeting, though none of the dealers opposed the revised scheme overtly, they were also not very upbeat about it. Mr. Tholkappian, a senior dealer from Madurai and one of the consistent performers, had the following things to say:

> "Sir, you know what is good for us and what is good for the company. We have full faith in you. We have always supported you and will continue to do so. It is difficult for us to predict at this stage as to how effective the new scheme will turn out to be .We will go back and put in our best efforts to make it successful. Should there be any problems, we will get back to you. Also, let us not ignore the overtures of Bhushan and Nezone. They are prepared to go to any extent to capture the market. In our quest for volumes, let us not play into the hands of our competitors. Unless you support us at this crucial juncture, I am afraid we cannot sustain our position in the market."

Tanmay was taken aback by these remarks. Ashwin, however, lightened the atmosphere by reaffirming his faith in the dealers and assuring them that the company was prepared to revisit the scheme after 6 months if things did not work out in favor of the dealers. All the dealers went back to their respective places with mixed feelings.

Twist in the Tale

There was no appreciable increase in sales during the second quarter (July- Sep). The third quarter began well, and during the first two months, that is, October and November, the company's sales grew by 14% on a year-on-year basis, which was a good news for Tanmay and his team.

During his visit to the Salem depot in the first week of December, Tanmay reviewed the performance of the dealers serviced by that depot. To his surprise, he found that in the previous 2 months, though the overall sales showed an increase of 15% over the corresponding period of the previous year, there was a considerable drop in the off take of Madurai, Trichy, and Kumbakonam dealers, while the lifting of the Coimbatore dealer was abnormally high. The Salem dealer, however, was performing consistently. Tanmay's findings are summarized in the Table 4.

On scrutinizing the dispatch documents, Tanmay observed that a lot of consignments billed on Sree Murugan, Coimbatore were actually delivered to destinations other than Coimbatore, but within Tamil Nadu. This was legally acceptable as there was no interstate movement of goods and, therefore, there was no evasion of the local sales tax. However, such transactions were too many in number for Tanmay's comfort. Tanmay was perplexed as to why some dealers were lifting lower quantity than the previous year and why the off take was abnormally high in the case of the Coimbatore dealer. Ambigapathi, in charge of the Salem depot, was not very helpful in unraveling this enigma. Neither was the marketing manager at the headquarters.

Tanmay decided to drive down to Coimbatore along with Ambigapathi to meet Mr. Subramanian, proprietor of Sree Murugan Traders to get the facts straight from the horse's mouth. After the customary exchange of pleasantries, they got down to brass tacks. Subramanian was not very keen on sharing the details of the quantities and sizes lifted by other Tamil Nadu dealers from him, but reluctantly opened his books on Tanmay's persistence. Tanmay was very much disturbed by what he discovered. Dealers in Madurai, Kumbakonam, and Trichy had lifted good quantities from the Coimbatore dealer in the last two months. While it was not uncommon for dealers to pick up sizes that were not readily available at the company's depot from other dealers close by to keep up the service levels, a scrutiny of the sizes and quantities lifted from the Coimbatore dealer by others revealed that those sizes were always in stock at the Salem depot. Furthermore, there was a definite pattern in terms of frequency, day of the week the materials were ordered, and the sizes that were repeated.

It was very clear that some of the dealers were lifting materials from other dealers instead of lifting from the company's depot. In the process, the Coimbatore dealer was heading for the highest slab, and the other dealers were not moving beyond the lowest slab of volume discount. Tanmay was baffled by this. Tanmay was clueless as to why such a behavior was exhibited by the dealers, which he thought was very unethical. On his return to

Table 4. Off take of South-West Tamil Nadu Dealers : Oct & Nov 2012 Vs 2013

	(Quantity in MTs)	
Dealer	**2012**	**2013**
Sree Murugan, Coimbatore	403	671
Ranganatha, Trichy	167	121
Meenakshi, Madurai	170	102
Sree Ramajayam, Kumbakonam	101	74
Sri Krishna, Salem	168	193
Total	**1009**	**1161**

Bangalore, he checked up with other depot in-charges to ascertain whether such abnormalities existed at other locations as well. To his relief, it was only at the Salem depot that such a racket was going on, and the transactions at other depots were quite normal.

Tanmay had a meeting with Ashwin after 2 days as the latter was preoccupied with the wedding of one of his nephews. Ashwin listened to Tanmay patiently but did not want to jump to any conclusion unless he had all the facts and figures, particularly on the impact of the revised discount structure on the company's bottom line. He instructed Nikhil Chinnappa, DGM (Finance) to analyze the profitability of the Salem depot based on the following assumptions and suggested that the three of them meet the following week, once the information required was ready.

(1) List price of steel tubes manufactured by DMP was ₹ 44000/MT (all inclusive). Trade discount was allowed on this price. So was turn over discount (TOD).

(2) TOD was allowed on the entire volume lifted, as applicable for the slab and not on the incremental volume alone.

(3) Contribution margin (selling price minus variable cost) was 14% of the selling price.

(4) There was no increase in fixed expenses because of the revised discount/incentive structure and consequent increase/decrease in volume.

Tanmay wondered as to what sort of analysis Nikhil was going to come up with and how he and Nikhil should present the peculiar scenario in South-West Tamil Nadu to the boss. He was not sure whether the company should allow such transactions to continue and how such aberrations could be detected and prevented in the future. He was as restless as a bumblebee, but unlike the latter, he had to find a logical solution to the problem before he met his boss along with his Finance counterpart.

-- END OF THE CASE ---

Dakshin Metal Products: Complexities of Channel Management

✷ **Teaching Note :** This case from the broad domain of channel management specifically deals with channel relationships, channel control, and channel conflicts apart from bringing out the inadequacy of bookish knowledge while dealing with certain practical situations.

✷ **Issues Dealt With :**

(1) Can the dealers be motivated only by monetary incentives?

(2) Does tweaking the existing scheme by making a few changes here and there and going ahead with its implementation without analyzing the possible consequences yield the desired results?

(3) Should not the channel partners be taken into confidence before making any major policy changes?

(4) Can managers always match the street smartness of channel partners?

✷ **Assignment Questions to Students (to be Communicated in Advance) :** Analyze the facts of the case from the top management's perspective and in case there is indeed a problem, suggest the course of action for Ashwin to overcome the same. Your analysis should cover the following aspects:

(1) Cost benefit analysis of the revised discount structure,

(2) Short-term and long-term implications of the present controversy.

Plan for Classroom Discussion

The discussion in the class room could be moderated on the following lines :

✷ **First 20 minutes:**

(1) What is the main issue?
(2) Does the revised discount scheme pep up the bottom line of the company ?

Students need to do the following analysis based on the information provided in the case in support of their arguments :

(a) Volume growth attributable to the revised scheme,
(b) Increase in selling and distribution expenses (Variable component).

(3) Does volume growth justify the increase in selling and distribution expenses?

✷ **Next 20 Minutes:**

(4) What made the dealers form a syndicate led by Sree Murugan? How does it benefit them?

(5) What are the consequences of the syndicate for :

(a) channel control,

(b) coercive power of the company,

(c) relationship among the dealers.

(6) Is there any possible nexus between the Salem depot in-charge and SW Tamil Nadu dealers?

✷ **Last 20 Minutes**

(7) Incase the impact on the bottom line is positive, should the management of DMP ignore the syndicate and continue supplying the material as usual to its various dealers?

(8) What are the possible consequences of precipitating the matter vis-à-vis maintaining the status quo?

Suggested Solution and Implementation Plan

Tanmay finds himself in an awkward situation thanks to the wily designs of the seasoned dealers who outsmarted him. Ashwin may give the benefit of doubt to Tanmay, considering his background and past record. He cannot, however, rely entirely on Tanmay to pull the company out of this chaos.

Ashwin should call for a meeting of all the dealers immediately and make it clear to them that the company takes a serious view of the dealers forming a syndicate. He should have one-to-one discussions with all the dealers to get their firm commitment that they will come out of the syndicate and operate independently like they were doing earlier. He may also involve Tanmay in the one-to-one interactions so that the latter does not get demoralized. In case the dealers ask for some time to disband the syndicate, he may allow a maximum of one month's time and insist that from the 4th quarter onwards, they all will operate independently. He should also take Ambigapathi to task for not keeping his boss informed of the undesirable developments, which could not have taken place without his connivance. With his charisma and long relationship with the dealers, Ashwin should be able to convince them not to take undue advantage of certain loopholes in the discount structure (the detailed working is given in the Appendix 1).

Managerial Implications

This case deals with the following aspects of channel management and control :

(1) Channel conflicts arising out of domain,

(2) Channel power,

(3) Need for effective channel information system (CIS),

(4) Management information system (MIS) and reporting,

(5) Importance of physical controls,

(6) Formal vs informal channels of control and power,

(7) Need for managers to be street smart.

Management graduates from reputed institutions, in spite of their pedigree and impeccable credentials, should not allow grass to grow under their feet. Tanmay learned this in a hard way. Text books on management and even case studies do not adequately capture the unconventional approaches adopted by channel partners, and managers who ignore this aspect are often outsmarted by the channel partners and field executives.

Change management is another crucial aspect that is often overlooked by avant-garde managers, who do not put in sufficient time and efforts to understand the dynamics at the field level. Unless they shed their ego and make sincere efforts to stay connected with the channel partners, they end up eating a humble pie. These aspects of channel management are not taught at business schools and have to be learnt the hard way by managers who should be prepared to work hands on at the field level. Industry leaders should not overlook this requirement, and should give due weightage to the street smartness of the managers hired and trained by them.

Apart from recruiting the right candidates, senior managers should ensure that their MISs (management information systems) and CISs (channel information systems) are robust and effective. Well designed control and information systems insure the organizations from the occasional lapses on the part of junior and middle level managers.

Conclusion and Key Learnings

(1) All possible consequences of a change need to be anticipated in advance and the affected parties need to be taken into confidence before going ahead with its implementation.

(2) The senior management of a company of the size of DMP should not allow grass to grow under its feet. They should have formal/informal channels of communication with the channel partners and need to keep a close track on the developments in the market place.

(3) Field employees should be under constant check and vigilance to preempt any possible nexus with the dealers. Periodic MIS reports, surprise checks and audits would discourage field people from indulging in activities that are against the interests of the organization.

(4) No dealer should be allowed to become more powerful than the organization. Syndicates formed at the behest of powerful dealers also distance other dealers from the organization and weaken the company's control on the distribution channel. This is not at all desirable considering the long-term interests of the organization.

(5) Even if there is no dilution of profitability, moves on the part of dealers to form syndicates should not be encouraged for the reasons elaborated under point 4 above.

Appendix 1

Cost – Benefit Analysis (only for Dealers Serviced by Salem Depot)

✷ **Situation A :** No change in discount and incentive structure. Assumed volume growth: 12 % (company has been consistently achieving this).

✷ **Situation B :** Additional volume growth of 3% due to revised discount and incentive structure (15% growth achieved).

✷ **Situation A :** Increase in volume assumed as 12% over LY. No change in discount structure.
Working of dealer discount and TOD, assuming list price of ₹ 44000/MT is given in the following table

Dealer	LY Volume Oct& Nov(MTs)	LY Trade Discount	LY TOD(pro-rata)	LY Total Discount
Sree Murugan	403	10.64	10.64	
Ranganatha	167	4.41	2.94	
Meenakshi	170	4.49	2.99	
Sree Ramajayam	101	2.67	1.33	
Sri Krishna	168	4.44	2.96	
Total	**1009**	**26.65**	**20.86**	**47.51**

Note: All figures in ₹ lacs except volume

As there is no revision in the discount structure (Situation A) and none of the dealers are crossing over to the higher slab, the total discount for TY works out to 47.51 x 1.12 = 53.21.

Increase in volume over LY=12% of 1009 =121 MT.
Increase in net contribution = 121x 44000 x14/100 = 7.45

This more than off-sets the increase in total discount of ₹ 5.7 lacs (53.21- 47.51).

✷ **Situation B**

No change in LY's total discount.
Working of this year's discount is as under:

Dealer	TY Volume(Oct&Nov)MTs	TY Trade Discount	TY TOD(pro-rata)	TY Total Discount
Sree Murugan	671	20.67	26.57	
Ranganatha	121	3.73	1.33	
Meenakshi	102	3.14	1.12	
Sree Ramajayam	74	2.28	0.33	
Sri Krishna	193	5.94	3.4	
Total	**1161**	**35.76**	**32.75**	**68.51**

All figures in ₹ Lacs except volume

This year's discount as per Situation B is higher than it is by Situation A by ₹ 15.3 lacs (68.51-53.21).

The gain in volume as per situation B =1161-1130 =31 MTs.
Additional contribution for 31 Mts =31 x 44000 x 14/100 =1.90 lacs

The revised discount structure, in fact, has adversely impacted the company's bottom line by ₹ 13.4 lacs! For an additional 3% growth in volume, the company has taken a beating of ₹ 13.4 lacs on the bottom line because of the syndicate formed by S.W Tamil Nadu dealers. Members of the syndicate, will, however, share this extra discount at the company's cost.