Title	Distribution strategy and accounting information
Sub Title	
Author	小林, 啓孝(Kobayashi, Yoshitaka)
Publisher	Society of Business and Commerce, Keio University
Publication year	1995
Jtitle	Keio business review Vol.32, (1995.) ,p.1- 15
JaLC DOI	
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Notes	
Genre	Journal Article
URL	https://koara.lib.keio.ac.jp/xoonips/modules/xoonips/detail.php?koara_id=AA00260481-19950000-00704489

DISTRIBUTION STRATEGY AND ACCOUNTING INFORMATION

by

Yoshitaka Kobayashi

Abstract

Retailers seem to be at the epicenter of the changes in intercorporate relationships and corporate behavior in Japan. But they have their own problems. The most important problem is the difficulty for retailers to sustain competitive advantage over long period. Constant adaptation to the changing environment is the key to sustaining competitive advantage. In this paper I propose the new accounting system named Dynamic Accounting for Sustainable Competitive Advantage (DASCA) to support environmental adaptation. DASCA consists of two sub-concepts : Accounting for Behavior and Duality Accounting. DASCA differs from traditional accounting designed for decision-making in three ways : it uses non-accounting information ; it makes dual analysis ; and it conducts followup consistent with the hypothesis. By maintaining a dual view, accounting can describe, as faithfully as possible to reality, the multifaceted dynamism of corporate activities and help sustain competitive advantage.

Key Words

retailer, competitive advantage, adaptation to the changing environment, Accounting for Sustainable Competitive Advantage (DASCA), Accounting for Behavior, Duality Accounting, decision making, strategy

1. Changes in intercorporate relationships and corporate behavior in Japan

The economic influence of retail corporations has been growing of late, primarily because of diversifying demand and rising price-consciousness among consumers. Retailers are at the epicenter of the changes in intercorporate relationships and corporate behavior.

Momentum is growing to expand house branding and overseas development for re-importation. Even "national brand" manufacturers are furnishing house-brand products to specific retailers. For instance, Daiei Inc.'s photographic film, made by Agfa, is having a significant impact on the business of other film makers. Alliances between manufacturers and retailers are proliferating, such as the partnership between Daiei and Ajinomoto Co., a fresh bread supply network set up jointly by Seven Eleven, Ajinomoto, and Itochu Corp., and a joint venture among five major ice cream makers and Seven-Eleven.

In this paper I will discuss the roots of these changes among retailers and manufacturers. Based on that discussion I will try to clarify what is needed for sustained competitive advantage, and discuss what I think is desirable management accounting to that end.

2. Manufacturer problems with distribution channels

As their production bases recovered from the negative effects of the second world war, home-appliance, toiletry and other consumer product makers in Japan needed outlets for mass-produced goods. Most retailers were small and weak right after the war ; none were large enough to sell products in substantial volume. To address this problem manufacturers signed partnership or agency agreements with wholesalers, organized small retailers under those contractors and so built or expanded sales channels. Some, like Kao Corp. and Shiseido Co., established their own marketing subsidiaries.

In this way manufacturers formed their sales channels into networks of affiliated companies known as *keiretsu* and maintained them though retailer incentives like the quotation system and the rebate system. Under the quotation system, the manufacturer quotes both wholesale and retail prices. When the system is working properly, manufacturer prices are fixed and even the smallest retailers can be guaranteed a certain profit margin, making it easier to run stores than when prices fluctuate.

The quotation system worked well when the Japanese economy was in the long period of high growth that spurred high-volume sales of mass-produced goods. But this manufacturer-directed system began to cause friction between manufacturers and retailers with the development of larger retailers, such as mass retailers. The conflict between Matsushita Electric Industrial Co. and Daiei is a good example.

As the Japanese economy matured, on one hand with the development of volume sales routes by large retailers and convenience stores and on the other with the diversification of consumer demand and shortening product life cycles, *keiretsu* marketing became a disadvantage to manufacturers. For example, consider Matsushita's National stores. Though they had contributed to the company's market share and were one of Matsushita's sources of strength, it grew harder for the company to maintain its network of 27,000 National stores. The company chose 18,000 stores for reorganization into MAST and dissolved its store network in the spring of 1992.

In response to diversifying demand manufacturers expanded their product types. But this hurt profitability within product categories. This is because sales per product category fell while diversification complicated every process, from product development to distribution.

As consumer needs diversified and lifestyles embraced greater individuality, once-loved sales campaigns and brands lost significant appeal. Increasingly manufacturers were in the dark about what would sell, and the "face" of the consumer became increasingly vague. The decay of brand power is particularly evident after the bursting of Japan's economic bubble.

Manufacturers make various kinds of products because they are not sure which ones will sell. Since very few are truly successful, they are forced to continually come up with new products. This easily becomes a vicious cycle.
The business environment is changing in ways that press manufacturers to make drastic changes in their traditional pricing and distribution policies : the bubble formed and burst, the rising value of the yen makes international price

differentials particularly acute, discount stores gather power by responding to changes in consumer awareness and promoting price-consciousness, and low-priced house brands and imports from mass retailers like Daiei, Ito-Yokado Co. and Jusco Co. compete with manufacturer brands. To this situation I attribute the recent attitude among manufacturers toward retailers and convenience stores as seen in their business relationships.

3. Retailer problems

It is often said that it is difficult for retailers to sustain competitive advantage over long periods (Levy-Weitz, 1992, p. 15). Since retailers purchase their products from somewhere else, they often find their competitors selling the same products. In addition, specialization is difficult ; store designs, product assortments, "unique" services and ideas are easy to copy. The retail business is relatively easy to enter. Retailing requires no production equipment or engineering technology, and startup costs are relatively low. These low barriers to prospective retailers, combined with manufacturer *keiretsu* policies and government policies to protect small retailers, have encouraged many small retailers to stay in business for long periods.

There have been many cases in which "unique" retailer services and ideas were easily copied. When Seven-Eleven started marketing boxed lunches, the Lawson and Family Mart chains immediately followed suit, as they did when Seven-Eleven introduced POS systems. To keep a competitive edge, a retailer must constantly improve and innovate.

The mass retailers, which came on the Japanese scene as "price busters," now have a higher profile and their products are no longer inexpensive. They have become high-cost operations partly because of the high cost of starting a new store under the dictates of the Large-Scale Retail Stores Law. Discount stores, sometimes known as "category killers," have recently entered the market and begun to gather market share. In this business environment, the mass retailers had to offer prices low enough to compete with the discounters even as they were pressed to sell high-margin products to compensate for their higher operating costs. The simple result is that house-brand products burgeoned in mass retailers. Men's clothing discounters like Aoyama Trading Co. have been losing sales to department stores and mass retailers selling low-priced suits. Retailers of one kind are always in constant competition with retailers of other kinds.

4. Key factors to sustain competitive advantage

To survive and grow, companies must sustain advantage over their competitors. Levy-Weitz presented two ways for retailers to maintain competitive advantage (Levy-Weitz, 1992, pp. 201-209), one through external relationships, the other based on internal operations. External advantages are related to customer relationships, legal restrictions, and location. Internal advantages are related to merchandising control, store operations and retail control systems.

Levy-Weitz gave detailed suggestions for each component. In merchandising control, these included establishing better relationships with vendors, marketing exclusive merchandise, good product lineups and low prices. Store operation suggestions were better service, more visually appealing presentations and better store managers. Better management information systems, more efficient distribution and better inventory management were offered in terms of retail control systems.

If a company wants to sustain competitive advantage, there should be balance among these factors. Customers may be attracted to the one and only factor in which the company excels, but unless it is balanced by other factors, they will sooner or later be dissatisfied and loyalty will diminish over the long term.

The business environment changes with every passing moment, so there can be no guarantee that business methods that work today will work tomorrow. If the company is unaware of or misinterprets an environmental change and hangs on to one method, it will decline as it loses touch with its environment.

As mentioned previously, it is hard for a retailer to hold on for a long time to a relative competitive advantage. This is because one retailer's strategies are often easy to copy. Therefore to maintain advantage for a long time, a company must continue to generate new ideas and adapt. I have mentioned the factors that lead to relative competitive advantage for a corporation. Although they directly contribute to sustainable competitive advantage, the company must continually adapt these factors to stay ahead of its competitors. The key factor in sustainable competitive advantage is continuous adaptation to environmental change.

In maintaining that kind adaptation, there are three important points to bear in mind. First, to recognize the direction of ongoing change in the environment. The important factors in ongoing change that influence retail businesses are progress in diversification and individuation of consumer demand and value orientations. A value orientation is a consumer's tendency to buy a product with a relatively high ratio of benefits and functions to price. How should retailers respond to more diverse and individual needs and greater value orientation?

One way is to delegate authority to frontline employees, since they are likeliest to recognize customer needs and changes in them.

Information-sharing is also important. People are capable of thinking and creating, and given useful information they will use it to generate new ideas and improvements.

The second point to consider in sustaining adaptation is how to deal with uncertainty. In the real world, the future is unknown : our future is ambiguous and unpredictable. It is almost impossible to make a perfect prediction, draw a reliable plan based on that prediction and execute it. Nevertheless, companies must stay in business.

It may seem contradictory, but trying to prepare for uncertainty and minimize risk often reduces a company's ability to deal with uncertainty and harms profits. A typical example is consignment sales through department stores. The practice began in 1953 when Onward Kashiyama proposed such a deal to Mitsukoshi. With no risk to the retailers for the cost of unsold products, it immediately spread to department stores across Japan. What the department stores got in exchange for this risk hedge was lower merchandising skill and a permanent low-profit structure.

The third point to consider is to practice the philosophy of "living and prospering together." One company cannot respond to modern environmental changes on its own. A retailer buys products from wholesalers or manufacturers, and if the purchase is made to benefit only one party, the relationship will not last even in good times ; the retailer loses relative competitive advantage in the long run. If the retailer and wholesaler or manufacturer cooperate and share strengths, they can be more powerful than either could be alone.

It's easy to talk about these things, but carrying them out is another story. A manufacturer may become aware of the increasing sales volume of the large discount retailer, but it cannot overtly expand transactions with that retailer because it would put pressure on the business of its *keiretsu* stores. The long relationship with the *keiretsu* stores makes any change from traditional practices more difficult. Customers may ask the manufacturers for lower prices, but they must often turn down such requests because of conflicts over price-determination and the right to control sales channels.

5. Accounting for Sustainable Competitive Advantage

I have said that constant adaptation to the changing environment is the key to sustaining competitive advantage and pointed out factors to consider when putting this policy into practice. The next question is what kind of accounting is desirable to support that process. Before I go into that, there is one thing that I think executives should note : accounting information must not be a top priority in running a company. As we have seen, responding to the changing environment is important for a company in sustaining competitive advantage. This requires a first-hand view of reality. When a company bases its operations mainly on accounting information, as Johnson wrote in 1992, it becomes remote-controlled, losing touch with reality.

To support environmental adaptation, I would like to introduce Dynamic Accounting for Sustainable Competitive Advantage. DASCA consists of two sub-concepts : Accounting for Behavior and Duality Accouting.

6. Accounting for Behavior

The people in a company look at the company's environment and set goals, make plans and take action based on their subjective perceptions of it. Because human recognition is influenced by differences in individual brains and schema, it is impossible to see the environment objectively. It is possible, however, to create a model that is not far different from reality based on important factors for the company that are extracted from information collected from the environment. Providing clues to help executives understand the situation and pinpoint problems is an important function of accounting.

Getting an appropriate, complete view of the current corporate environment is already a difficult task. Getting a future view is even harder because of its inherent ambiguity and uncertainty. Even so, the actions a company takes are related to its future, and the prediction of social trends is necessary for goal-setting and planning. It is helpful in drawing up plans if causal relationships and correlations between phenomena are known.

Accounting information alone is not enough for a company to accurately evaluate the current environment and predict future trends. Combining accounting informartion with other information is crucial. To evaluate the corporate environment and make predictions, DASCA requires the integrated use of accounting and non-accounting information.

If a company determines which and how many products to purchase based solely on accounting information, it will use either sales information or profit rates. With insufficient understanding of why a popular product sold so well, it is possible for a company to purchase the product in great volume even though the basis for its popularity no longer exists. There is no guarantee that a highly profitable product will sell as well as the company would like. Nonaccounting information, like what sorts of products have been purchased when by which sex of what age group in what weather during what special event, if any (e. g., an athletic meet), must be collected. If non-accounting information is analyzed with accounting information over time, and the relationships between specific phenomena and sales are understood, even when only vaguely based on analysis, there is greater likelihood that purchases will be appropriate.

There is a widespread notion that Point-Of-Sales systems make order-placing automatic. Since the systems make sales volume figures available for each product, when used in combination with purchasing information they can track inventory volume. Then orders are placed automatically by computer whenever inventories drop below preset standards.

This is attractive. If ordering is automatic, ordering labor costs can be cut and there is no danger of products going out of stock and subsequently missing sales opportunities. In reality, automatic ordering spoils a company's ability to adapt to the environment——in the long run the store eventually fills up with products that no longer sell.

The corporate environment is changing constantly, and so are consumer preferences. There is no guarantee that yesterday's hot product will sell today because demand may shift from one product to another. An order for the same product to replace the sold one is an order for yesterday's hot product. If today demand shifts, that newly ordered product will go unsold. Where orders are repeated despite a shift in demand, the store fills up with unsold products.

This suggests two points. First, POS and other information systems alone can neither improve sales nor sustain competitive advantage, regardless of how good they are. The problem is not with information system themselves, but in how we interpret and use the information we get from them. Second, except where it makes no difference in terms of result whether a person or a computer does the job, people must use the information, think and make decisions.

In purchasing, people must process accounting and non-accounting information from information systems, evaluate the purchasing situation and make purchasing decisions that suit the situation. When people in charge of purchasing understand the situation and make decisions based on that understanding, they are making hypotheses about which product will sell how much for what reason.

To improve purchasing or have purchasing change to suit the changing environment, the company must track whether the purchasing people are making useful hypotheses and predictions. This kind of followup builds up correct information on the environment and purchasing, and corrective action can be taken when necessary. To determine the utility of the hypotheses or predictions, accounting information may be used. To understand the act of purchasing as fully as possible, non-accounting information should be used in combination with accounting information to visualize what happened more vividly.

Ito-Yokado has its purchasing people formulate a hypothesis——that a certain product will sell for certain reasons——before ordering anything, purchase based on the hypothesis, and check the results using information from POS and other information systems. Purchasing may be done without a clear hypothesis, but in those cases the company can only learn through POS data that products have sold in a certain volume ; it gets few clues as to why they sold or didn't sell. Without a hypothesis, the company has difficulty using the information to improve purchasing or alter it to fit the new environment.

Where there is a clear hypothesis for purchasing, on the other hand, the proof of the hypothesis is obtained in good or poor sales. When the product doesn't sell despite the prediction, it is likely that reasons will be discussed, another hypothesis will be made, and by doing so purchasing will better suit the environment. DASCA is aninformation system that allowsfor the formulation and evaluation of hypothesis. DASCA is accounting for better action, designed to improve action by repeating the cycle of hypothesis, action and followup.

Here purchasing was taken as an example, but DASCA's hypothesis and followup also targets other business goals, like cost-cutting in store operations and business system improvement. To make and follow up a hypothesis in such cases, a reasonably accurate prediction of the results of a given alternative must be made at the hypothesis stage. For that purpose, the structure of the company's activities and functions must be clarified, and cost-and-quantity data for each activity or function must be collected. If this preparation is done, corporate activities and functions can be described in accounting terms and there will be a better chance of accurately predicting the results of an alternate idea. The collection of cost-and-quantity data for each function and activity, as required for Activity-Based Costing, is prerequisite to DASCA.

DASCA differs from traditional accounting designed for decision-making in three ways : it uses non-accounting information ; it makes dual analyses, which will be discussed later ; and it conducts followup consistent with the hypothesis.

To form a hypothesis, DASCA uses conventional methods if useful. When causal relationships are more or less visible, a hypothesis is easy to make. Even when such relationships are invisible, followup will be easy if a predictable set of causal relationships can be sorted in a structural way. The use of a cause-and-effect diagram, for instance, is recommended.

Accounting has important functions in describing a situation : it focuses attention and reveals probrems. Budget/actual variances, standard/actual variances, displays of sales or cost trends, and comparisons with other companies are specific examples.

Recent changes in the distribution industry include a cooperative transportation arrangement among wholesalers for Seven-Eleven, category management (as represented in the action by processed food wholesaler Ryoshoku, Ltd.), strategic alliances between manufacturers, wholesalers and retailers for efficient consumer responce, mergers and partnerships between wholesalers to build full product lines, and the alliances between retailers and manufacturers forged by Daiei, Jusco, and Ito-Yokado.

To make these changes, the proposing party must convincingly explain the probable benefits to the prospective partner and win an agreement. To explain the benefits of the change and convince the other party, it is more effective to employ quantitative data-derived explanations along with qualitative explanations. In addition to describing the situation, accounting helps convince others. Accounting to describe a situation can sometimes be used as a convincing tool on its own, but at other times it is ineffective because information for describing a situation and that for convincing others have different purposes.

People at a negotiating table may vary in terms of degree of interest in and understanding of the proposal. Their accouting knowledge may differ. Every participant usualy has many problems to solve. In addition, negotiations have time constraints. Under such circumstances what is needed in accounting information is simplicity. If the information is so complex as to require conscious effort to understand, the proposers may find it difficult to draw the interest of their negotiating partners.

Similarly, accounting information must be clear. People generally want to accept whatever they are already more or less convinced of. If the accounting information presented is simple and clear, it promotes understanding in the people who see it.

To get a better understanding, it is better to present the information in a way that fits the thought processes of ordinary people in a convincing way. Consider an investment proposal. Making large profits from it is welcome, of course, but because of the uncertainty of the future, people would rather consider how much of the investment can be recovered in the worst case. Things can go worse than expected, the investment may be a money-loser, and investors want to know whether they can withstand the damage. Because ordinary people think more or less this way, accounting information should be provided in a way that follows the flow of their thoughts.

Information should be reliable. Where the information loses reliability, the proposal is less convincing. For example, processed food wholesaler Ryoshoku, Ltd. proposed "category management" to retailers in an effort to attract their consolidated business.

To buy a given product, traditional arrangements require the retailer to trade with the wholesaler that has a special relationship with that manufacturer. Thus retailers must deal with multiple wholesalers within product categories. With category management the retailer purchases all products within a given category from a single wholesaler.

Ryoshoku first explained the current situation——greater efficiency in store operations was needed due to environmental changes——and showed the current work load in store operations. Then it presented the advantages of category management : it would reduce auxiliary work like inspections, dock work and displays, which added up to more than half of all work done in the stores, and leave more time for the real work of waiting on customers ; less work would reduce operating cost ; and stores would be able to suggest to the manufacturer what kinds of products would sell.

Ryoshoku made the proposal more convincing by providing accounting and other quantitative information along with its qualitative information. To allow for this kind of communication, a company must understand the structures of activities and functions of itself and other companies and collect data, or make predictions, about costs and quantities for each activity and function.

7. Duality Accounting

In observing corporate management in Japan, I have a formed a hypothesis : Japanese companies have nimbly overcome many crises, including the oil crises and stronger yen, because each company incorporates contradictory elements and shifts from one to another depending on the situation. Emotional and rational values may contradict one another, but they comfortably coexist in a Japanese company. The coexistence of centralized and distributed authority is another example. Japanese companies often do business with greater emphasis on the emotional side when the business climate is relatively mild, and swing back to the rational side when the environment gets tougher. Even when a deteriorating environment shifts them to the rational side, they don't forget the emotional side ; they try to raise employee morale through emotional appeals.

I think this kind of duality is the source of the dynamism that a company needs for growth. When a company is dyed all one color, it more likely to lose its way when faced with an unexpected environmental change. Contradictory elements create tension, and the relationships between them may create something new.

This duality of vision is useful in accounting because it allows the company to evaluate multifaceted, dynamic phenomena with as much accuracy as possible and take actions that are not too far off the point.

The courier service Yamato Transport Co. has 200 offices in Hokkaido. According to the company, it would not have set up any offices in Hokkaido if it had determined its office locations solely on the basis of the projected profitability of each. Because its first three Tokyo distribution centers had reached their capacity limits, the company opened a fourth, much higher cost facility in Tokyo. If profitability had been the top priority, it wouldn't have done this, either.

Yamato evaluates store locations from the service point of view ; stores are distributed to give customers access in less than 30 minutes. Whether a given building can make a profit is not an issue ; what matters is that the entire courier service network works in the best way.

Returning to Yamato's fourth Tokyo terminal. The company knew it could not handle more parcels if it continued business with only three terminals. It determined that the fourth terminal itself might lose money, but that this would be necessary to increasing transaction volume for the network as a whole.

Yamato makes an income statement for each office, recording actual budget and year-on-year comparisons for each month.

In accounting, dual vision must be general. For instance, calculations must be made from the macroeconomic standpoint, which looks at the company as a whole, as well as the microeconomic standpoint, which looks at each part of the company, to determine the company's best direction. With microeconomic calculations alone, such as the profitability of each product, the company will likely lose profit over the whole operation. If the entire operation alone is in view, the company's agility and resilience will suffer, and it will head toward a decline.

The same thing can be said about short-term and long-term views. If a company thinks of profit only in terms of a short period, it may make decisions that negatively affect the sustainability of its business and growth. If it thinks only in terms of long-term profit, it may not gather the resources for growth tomorrow, which may even jeopardize its existence. To sustain competitive advantage, both long-term and short-term profit calculations are necessary.

From the accounting viewpoint, I think the basics of corporate management are to gather the funds returned from investment in the business and reinvest the surpuls for the survival and growth of the company. Therefore, I think calculations should be made to track return on investment along with accrued profit-and-loss calculations. By calculating how much of the investment is returned, a company can keep track of return for each project and use the data in forming competitive strategies.

Akira Koike, an adviser to NEC Corp., proposes to calculate an input/output statement along with ordinary profit-and-loss calculations(Koike 1993). The I/O statement is the difference between input and output over a specific period. The purpose of calculating the I/O is to determine whether ongoing input is appropriate advance investment for expansion of the business and desired results. NEC recently started calculating its In/Out statement, which is a bit different from Koike's I/O statement, and has made management of that calculation a standard practice.

By maintaining a dual view, accounting can describe, as faithfully as possible to reality, the multifaceted dynamism of corporate activities and help sustain competitive advantage.

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