

Stockholm School of Economics
Master Thesis in Marketing

Mobile Phone Distribution Channel Structure in China

Supervisor: Per Andersson
Examiner: Anna Nyberg
Author: Chuan Huang 80294
Opponent: Ying Gao 80290
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Abstract:

China is the biggest mobile phone market in the world and the Chinese market is still growing fast every year. It raises significant question for the mobile phone manufacturers on how to better capture the opportunities in the booming Chinese market. Distribution channel is one of the major difficulties in front of both foreign and domestic manufacturers. Mobile phone industry is with no exception. Therefore I set out to study the channel structure of mobile phone in China. Two research questions are aimed to be answered: 1. What is the evolvement of mobile phone channel structure in China? 2. What could the future mobile phone channel structure look like? Based previous channel theories, I formulate a framework of Channel structure in terms of four dimensions-institutions, functions, conflicts and networks and channel structure's interaction with channel strategy. Research question 1 was answered by using the framework for analysis. Based research question 1's analysis, two future scenarios are proposed.

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1. Introduction

1.1 Background

China is the largest mobile phone market in the world, with 363.168 million subscribers by the end of June 2005¹. For the past four years, annual increase of subscribers amounts to as many as 60 million (see Appendix). It raises significant question for the mobile phone manufacturers on how to better capture the opportunities in the booming Chinese market. Good products and a strong brand are not enough. What's more important, the products have to get through the right marketing channels to the target consumers efficiently. However, channels have always been a perplexity to foreign manufacturers and sometimes even to domestic manufacturers in many industries because Chinese market is huge but fragmented and unbalanced in economic development between city and countryside, east and west. Mobile phone industry is without exception. "China is a unique market in that marketing channels play a very important role."² Said Sophy Zhang, Senior Analyst at telecom department of IDC. Indeed, in Europe and North America, operators take charge of marketing channels of mobile phones. Manufacturers mainly need to care about products. When it comes to China, manufacturers have to put a lot of extra effort on marketing channels. "The war of mobile phone manufacturers is ultimately the scramble for channels." said Colin Giles, Senior VP in Customer and Market Operations at Nokia China³. "The rise of Bird is totally due to the push of marketing channels." said a former manager at Bird, one of the most successful domestic mobile phone manufacturers.⁴ As the saying goes, "the one who has the channels has the market". Therefore, I found it interesting to research the topic of marketing channels of mobile phones in China.

1.2 Problem Area and Purpose of Study

I choose to study the changes in channel structure in the mobile phone industry and to understand why the changes took place. It is important for companies to understand changes in channel structure so that they can take appropriate actions in adjusting their channel strategy and foresee future trend and take proactive actions. For researchers, it is also meaningful to study changes of channel structure in China. Previous researches concerned with channel structure in China usually dealt with evolvement of general channel structure from a political point of view and most of them were done before mid 90s(see reference). However, substantial developments have taken place in China since mid 90s. By focusing on mobile phone industry, this paper shall contribute to the extant knowledge about marketing channels in China by

1 Data from Ministry of Information Industry, www.mii.gov.cn

2 http://www.idc.com.cn/about/detail_mediareports.jsp?id=5

3 <http://past.people.com.cn/GB/it/50/145/20030117/909854.html>

4 <http://global.factiva.com/zhcn/arch/display.asp, document CEINCN0020050803e1830007r>

investigating the latest situation. A conceptual framework which attempts to incorporate many previous perspectives on looking at channel structure will be formed. Analysis under this framework shall provide a comprehensive view about the phenomenon.

The following specific research questions are aimed to be answered:

1. What is the evolvement of mobile phone channel structure in China?
2. What could the future mobile phone channel structure look like?

The two questions are interrelated and the answers to them shall shed light to the dynamics of the channel structure.

1.3 Delimitation

This study will view channel structure from the perspective of mobile phone manufacturers. While mobile phones in the US and many European countries are sold through operators, in China they reach market through retail outlets like consumer goods. Manufacturer brand is one of the most important factors in purchase decision and therefore manufacturer is, so to speak, the “channel captain”⁵.

2. Previous Research on China’s Marketing Channels

“The pre-requisite for selection of marketing channels for the Chinese market is, in addition to the strategic needs of the firm, a thorough understanding of its substantive channel structures and patterns and characteristics of channel members’ marketing behavior.” (Sherriff T.K. Luk, 1997) This might explain why researches about marketing channels in China center on two areas- channel structure and channel power.

Earlier researches in the 90s (see reference) focused on China’s channel structure from political and institutional perspective. These studies attributed the development of marketing channels in China to a large extent to the economic reforms carried out by Chinese government. They aimed to identify the general characteristics of Chinese channel structure by analyzing a few industries or geographical regions and to provide suggestions for foreign entry.

More recent researches focused instead on the behavioral aspect of Chinese marketing channels. For example, Zhuang and Zhou (2002) studied relationship between power and dependence in China’s marketing channels. They found that, contrary to Western channel theory that a channel member’s power is derived from the other’s dependence

⁵ According to Coughlan (2001), channel captain is a channel member that takes the keenest interest in the workings of the channel for this product or service, and that acts as a prime mover in establishing and maintaining channel links.

in the channel dyad; their empirical data in China supported a reversed relationship between power and dependence. Dickson and Zhang (2004) assessed power theory on China's marketing channels and found the theory is helpful in illuminating relationships, but as a whole it is not well-supported. They speculated this is due to cultural variables.

Generally, researchers were cautious in applying Western theories on China because Chinese marketing channels was under strong government control and culture influence and displayed features of an emerging market. "*As there are ample differences in the channel environment between China and Western countries, channel management techniques that are derived based on the experiences in the West might not be compatible with the requirements in China*". (Sherriff T.K. Luk, 1997) This study also bears this in mind. However, this generally will not be an big issue as the paper uses pattern-matching method, which is to compare an empirically based pattern with a predicted one or with several alternative predictions. This will also be discussed in methodology part.

3. Theoretical Framework

I will bring up the following theories on marketing channels: institutional school, organizational approach, functional approach, behavioral school, political economy approach, interaction approach and network approach. These different theories take on different perspectives on marketing channels and serve as a foundation to form a comprehensive framework for analyzing mobile phone channels in China.

3.1 Theories on Marketing Channels of Consumer Goods

Gattorna suggested to group studies on distribution channels into institutional, organizational, functional and behavioral schools of thought (Pia Polsa, 1998, P7). Polsa added three more recent ones: the political economy approach and the interaction and the network approaches.

According to Gattorna, the institutional and organizational approaches have paid most attention to actors in the distribution process, e.g. intermediaries and facilitating agencies (Pia Polsa, 1998, P7). *The institutional school* aims to answer questions concerning the optimal length or structure of the distribution channel, and *the organizational approach* focuses on leadership and loyalty in the channel, since the entire system is seen as an integrated whole (Pia Polsa, 1998, P7).

The functional approach is very much related to the institutional school of thought but with a different focus. It regards activities as the elements that explain the existence of the actors, and the actors are defined through their functions. The aim is to describe and categorize functions, and explain the structure of distribution through activities (Pia Polsa, 1998, P8).

The behavioral school takes distribution as a behavioral system and pays attention to the fifth area, i.e. the means of influence. According to Gattorna, the distribution system is defined as a behavioral system, and the aims are to study how power is achieved, how to define conflict and identify conflicting behavior and sources of conflict, and how to determine and manage its consequences (Pia Polsa, 1998, P8).

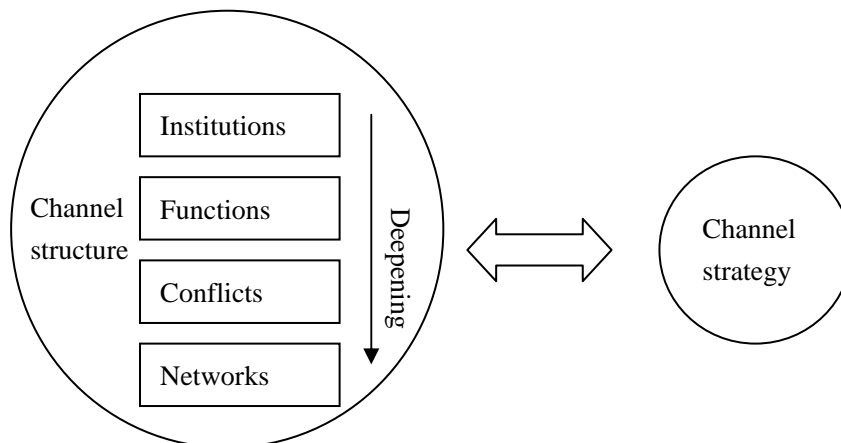
The political economy approach stresses the importance of environment. The emphasis in this paradigm is on inter-organizational relations, dependence and power, and the external environment of inter-organizational system (Pia Polsa, 1998, P8). This school also includes researches focusing on contextual analysis of distribution channel in different countries.

Both the network and the interaction approaches seem to provide a largely holistic conceptual frame for distribution studies. *The interaction approach* examines actors, the interactions between the actors in a dyad, the environment in which these interactions take place and the atmosphere affecting them (including the means of influence). *The network approach* looks at the same aspects but focuses more on the entire network and the transformation of the resources in it. The research questions focus on the effects of dyad relations between the actors and the relationships in the network, the interaction in these relations and the effects the external environment and means of influence. The time dimension is also included, and longitudinal studies of the evolution of actor relationship are emphasized. The analysis is on both organizational and individual levels (Pia Polsa, 1998, P9).

From discussion above, several important dimensions about marketing channels can be identified from different schools of theories: institutions/actors (institutional and organizational approach), functions/marketing flows/activities (functional approach), power, dependence and channel conflict (behavioral approach), and relationships, environment and networks (political economy approach, interaction and network approach). The different perspectives display an increasing understanding of channel structure from the most obvious dimension- the institutions to the most elusive dimension- the direct and indirect relationships between the institutions and their environment. By viewing the marketing channels of mobile phone industry in China from the aforementioned dimensions, a complete picture of the overall mobile phone channel structure can be formed. This includes what the mobile phone channel structure used to be and what the channel structure is now and how it has changed over time. In this way, the first research question “What is the evolvement of mobile phone channel structure in China?” can be answered. At the same time, based on the understanding of the evolvement of mobile phone channel structure in China, the second question “What could the future mobile phone channel structure look like?” can be answered using the same perspectives.

3.2 Conceptual Framework

I selected the dimensions that I feel most relevant with the mobile phone industry and integrated them into the following conceptual framework.



3.2.1 Definition of Channel Structure

Traditionally channel structure refers to “*the types of channel members that are in the channel, the intensity or number of members of each type that coexist in the market, and the number of distinct channels that coexist in the market*”⁶. This definition covers the institutional dimension of channel structure but is inadequate to capture the full meaning of the term. According to Bucklin (1966), the channel is fundamentally a method for organizing work, and since functions describe work, the function concept is natural for defining channel institutions. The institutional structure is the division of functions among separate organizational entities while the functional structure of the channel maybe regarded as the number and types of functions to be found in the product and title flows. If we treat institutions and functions as the atoms in the channel structure, the other dimensions such as power, dependence, influence, conflicts and relationships are the threads connecting the atoms. Only with both the atoms and the threads, a channel structure can be formed. Therefore, I define channel structure in this paper in its full sense as *the types of channel members that perform a certain combination of functions, the number of members of each type that coexist in the market, the number of distinct channels that coexist in the market, the dependence and conflicts between horizontal and vertical channel members, and the relationships in the network of channel members and their environment.*

3.2.2 Definition of Institutions

Institutions are the actors or channel members in a certain industry. In mobile phone industry they are manufacturers, intermediaries and end-users.

Mobile phone manufacturers are easy to identify since they produce branded items.

⁶ Coughlan et.al. 2001, P109

There are many OEM manufacturers who do not have the license to sell mobile phones in China and therefore sell under others' brand name. Those manufacturers are not considered in this paper.

The intermediaries stand between manufacturers and end-users. In China's mobile phone market, we differentiate three types of intermediaries: distributors, retailers and operators. Distributors are divided into national distributors, provincial distributors and local distributors based on their size and geographical coverage. Retailers are divided into local phone stores, department stores and supermarkets, professional phone chain stores and home appliance chain stores. In channel literature, there is another type of intermediaries called specialized intermediaries who perform a specific flow and typically are not heavily involved in the core business represented by the product sold. These intermediaries include insurance companies, finance companies, credit card companies, advertising agencies, logistics and shipping firms, information technology firms, and marketing research firms. In this study, they are taken into consideration only when it is necessary to analyze or explain other actors' accounts.

End-users collectively play a role in channel structure since they perform certain channel flows sometimes, for example, assembly in the case of IKEA. The service output (time, place and lot size utilities) demanded by end-users influence the intermediaries and manufacturers' channel strategy. However, this paper will only focus on the commercial sector involving retailers, distributors, operators and manufacturers.

3.2.3 Definition of Functions

Bucklin (1966) defined a marketing function as *“a distinct type of task found in the product and/or title flows and whose component activities are so interrelated that they are generally preformed or closely controlled, by a single institution”*.

The fundamental reasons for existence of channel are both demand-side factor and supply-side factors. On demand side, marketing channels facilitate search and adjust assortment discrepancy. The sorting function performed by intermediaries includes the following activities: sorting out (breaking down a heterogeneous supply into separate stocks that are relatively homogeneous), accumulation (bringing similar stocks form a number of sources together into a larger homogeneous supply), allocation (breaking a homogeneous supply down into smaller and smaller lots), assorting (building up of an assortment of products for resale in association with each other). Intermediaries create possession, place and time utilities by having a product in their assortments, in certain place, and at certain time that are all valuable to the target end-user. On supply side, marketing channels help routinization of transactions and reduction in number of contacts.

Manufacturers, wholesalers, and retailers as well as other channel members exist in channel arrangements to perform one or more of the following generic functions: *carrying of inventory; demand generation, or selling; physical distribution; after-sale service; and extending credit to customers*. (Coughlan et.al. 1998) In getting its goods to end-users, a manufacturer must either assume all these functions or shift some or all of them to channel intermediaries. An important principle in the structure of marketing channels is one can eliminate or substitute institutions in the channel arrangement, but the functions these institutions perform cannot be eliminated; when institutions are eliminated, their functions are shifted either forward or backward in the channel and therefore, are assumed by other members.

To the extent that the same function is performed at more than one level of the marketing channel, the work load for the function is shared by members at all levels. Therefore, Coughlan et.al. (2001) prefers to use the term “*flows*” rather than functions to emphasize that these processes often flow through the channel, being done at different points by different channel members. There are eight generic channel flows: *physical possession, ownership, promotion, negotiation, financing, risking, ordering and payment*. This duplication and redundancy in the channel may increase the distribution cost. However, the increase in cost is justifiable to the extent that it may be necessary in order to provide goods to customers at the right quantity, time and place. If the increase in cost cannot be justified, then redundancy is wasteful and inefficient. It is not necessary that every institution participate in the furtherance of all of the flows. Marketing intermediaries, through their experience, specialization, contacts, and scale, offer other channel members more than they can usually achieved on their own in terms of their superior efficiency in the performance of basic marketing task and functions. (Coughlan et.al. 1998)

3.2.4 Definition of Conflicts

Kotler (2001) defined channel conflict as “*disagreement among marketing channel members on goals and roles- who should do what and for what rewards*”. Coughlan (2001) stated that “*channel conflict arises when the behavior of a channel member is in opposition to its channel counterpart. It is opponent centered and direct, in which the goal or object sought is controlled by the counterpart*”. Conflict is a normal state in a channel. A certain amount of conflict is even a desirable state for purposes of maximizing channel performance.

According to Coughlan (2001), major sources of conflict are competing goals, differing perception of reality and clashes over domains. *Goal incompatibility* occurs when channel members have differing goals and engage in behavior that gives rise to conflict and dissatisfaction. *Perceptual incongruity* occurs when channel members perceptions of reality differ in some way, and while these may have the same goals, these may support different solutions to a particular problem. *Domain clash* refers to those disputes that arise as a result of disagreements with respect to areas of decision

making responsibility. Conflict occurs when one channel member perceives that the other is not taking proper care of its responsibilities in its appropriate domain. This can mean doing the job wrong, not doing the job at all, or trying to do the other channel members' job. (Magrath & Hardy)

One of the most serious domain clashes is *intra-channel competition*. From the upstream viewpoint, the problem of domain clash occurs when a supplier sees its downstream partners represent its competitors. From the downstream viewpoint, domain clash occurs when a supplier sells through many of the firm's direct competitors in a market. Another source of domain conflict occurs when multiple types of channels represent the supplier's products to the same geographical market—the so-called *multiple channels*. A third type of domain clash is *gray market*. Gray marketing is the sale of authorized, branded product through unauthorized distribution channels—usually bargain or discount outlets that provide less customer service than the authorized channels do. Gray marketing can be contrasted with black marketing, or counterfeiting, which involves selling fake goods as branded ones.

Kotler (2001) divided channel conflicts into horizontal conflict (conflict among firms at the same level of the channel) and vertical conflicts (conflicts between different levels of the same channel) based on channel members involved. Vertical integration can be viewed as a source of vertical conflict. According to Coughlan (2001), an outside party has six advantages in performing a channel function: motivation, specialization, survival of the economically fittest, economies of scale, heavier market coverage and independence from any single manufacturer. Generally, outsourcing distribution is thought to be more efficient. However, a few company-specific capabilities justify vertical integration: idiosyncratic knowledge, relationships, brand equity when driven by downstream activities, dedicated capacity, site specificity and customized physical facilities. In the presence of significant specificity, uncertainty favors outsourcing. In addition, vertical integration's purpose is to reduce performance ambiguity.

What needs to be point out is that behavioral approach is certainly not only about conflicts. Power and dependence are also important dimensions in this school. The reason why only conflict is selected in my framework is that conflict is most relevant to channel structure. The horizontal and vertical conflicts to a greater extent determine how the manufacturers and intermediaries are combined to work together. Power and dependence, on the other hand, are more related to the links between different actors which can be better analyzed using network theory.

3.2.5 Definition of Networks

According to Ford (2003), a business market can be seen as part of a network where the nodes are business units, such as producers, customers, service companies and supplier of finance, knowledge and influence, and the threads are the relationships

between the companies. The business units or nodes consist of physical, technical and human resources bound together in a variety of different ways. Similarly, each relationship arises from the investment of physical and human resources by both companies. The network is not a world of individual and isolated transactions. It is the result of complex interactions within and between companies in relationships over time.

There are three network paradoxes: first, a company's relationships are the basis of its operations, growth and development and are at the heart of its survival. But these relationships may also tie it into its current ways of operation and restrict its ability to change; second, a company's relationships are the outcomes of its own decisions and actions. But the paradox is that the company is itself the outcome of those relationships and of what has happened in them; third, companies try to manage their relationships and control the network that surrounds them to achieve their own aims. This ambition is one of the key forces in developing networks. But the paradox is that the more that a company achieves this ambition of control, the less effective and innovative will be the network.

Relationship is the key word in network theory. Ford (2003) defines relationship as the pattern of interactions and the mutual conditioning of behaviors over time, between a company and a customer, a supplier or another organization. According to Ford (2003), the substances of a relationship include actor bonds (contacts between individual actors from the two companies), activity links (interlocking of behavior of the two companies) and resource ties (the mutual adaptation of resources in the companies). Relationships have three facets. First, the relationship is a device to achieve efficiency and innovation and to influence others. Second, the relationships are a company's most important assets, because without them it cannot gain access to the resources of others, acquire the supplies it needs, or solve its customers' problems and thus generate revenue. Third, relationships are difficult to handle and always involve actual or potential problems.

In a business market, companies could be involved in a network which contains many sub-networks such as supplier network, customer network, distribution network and different national networks. Distribution network is a sub-network that I will focus on. A main characteristic of distribution networks is the occurrence of indirect relationships. All actors are embedded in relationships and each of these relationships is embedded in others. One important characteristic of a distribution relationship is the level of complexity of the distribution solution that is applied. Some users may favor advanced and costly distribution arrangements while others prefer less advanced, less complex and therefore less costly solutions. The second important dimension of a distribution relationship concerns the level of involvement between supplier and customer.

It is relevant to bring up the internationalization theory according to the network

approach proposed by Johanson & Mattsson (1988). According to the network model, the internationalization of the firm means that the firm establishes and develops positions in relation to counterparts in foreign networks. This can be achieved (1) through establishment of positions in relation to counterparts in national nets that are new to the firm. i.e. international extension;(2) by developing the positions and increasing resource commitments in those nets abroad in which the firm already has positions, i.e. penetration; and (3) by increasing co-ordination between positions in different national nets, i.e. international integration.

3.2.6 Definition of Channel Strategy

After looking for many marketing channel literature, I found channel strategy is not a topic to be studied in a general term. Rather, channel strategy is decomposed into smaller aspects. For example, channel strategy adaptation in terms of channel configuration such as multiple channels and composite channels, direct and indirect channels (Rangan, V. Kasturi & Nueno, Jose L. 1999) Coughlan et.al. (2001) does not discuss the concept of channel strategy. Instead, channel design and channel implementation are discussed in depth. Channel design is discussed in terms of segmentation, positioning, targeting and establishing new channels or refining existing channels. Channel implementation is discussed in terms of power sources, channel conflicts and channel coordination. Therefore, here I feel it makes sense to define channel strategy as supply-side channel decisions with regard to channel design and implementation.

Specifically, with regard to channel design, the decisions include:

- Who should be in the channel? (Direct marketing, sales force or intermediaries. Should intermediaries be used at all? What types of intermediaries should be used?)
- How many levels of intermediaries should there be?
- How many channel members should there be at a given level of the channel? (intensive, exclusive or selective distribution)
- Single channel or multiple channels?
- Vertical integration or outsourcing distribution?

As to channel implementation, it usually deals with:

- How to obtain channel power and make use of it?
- How to manage conflict to increase channel coordination?
- Vertical integration or vertical marketing systems (strategic alliance)?
- Disintermediation?

Answers to the above questions constitute the major aspects of a manufacturer's channel strategy. These questions boil down to the previous four dimensions in the framework: institutions, functions, conflicts and networks. Manufacturers have to decide what they are going to act upon the four dimensions of current channel

structure and what they want future channel structure to be.

3.2.7 Summary of Conceptual Framework

The four dimensions form a holistic view about channel structure from the most obvious dimension to most elusive dimension. The relationship between channel structure and channel strategy is two-way. A firm has to act upon the given situation of the four dimensions in a market to decide channel members, to divide functions, to resolve conflicts and to develop network relationships. However the macro channel structure changes after implementation of different manufacturers' channel strategy, which in turn cause manufacturers' to adjust or make new channel strategies. This dynamic two-way process continues and causes channel strategy and channel structure to evolve over time. This should be able to answer the first research question: "What is the evolvement of mobile phone channel structure in China?" Answer to the second research question "What is the future mobile phone channel structure going to look like?" will be derived from the analysis of first question.

In reality, several other factor also influence macro channel structure such as legal and political environment, economical development level, social and cultural background etc. My framework is a simplified abstraction, taking other factors as given, i.e. China' environment from 1995 until now.

4. Methodology

4.1 Research Design

McKenna noted as early as 1991, that "*successful marketing practices primarily are based on qualitative approaches and, not on quantitative studies favored traditionally, many times focusing on trivial details*". As the purpose of the study is to analyze the evolvement of mobile phone channel structure and to explain why and how channel structure changes, a qualitative approach is used.

Two cases are added to give more specific data. In establishing the number and types of cases needed, Glaser and Strauss use a comparative method, i.e. they choose cases which represent different aspects of reality. "*The actual number of cases needed in a specific study will be determined by saturation, i.e. the diminishing marginal contribution of each additional case; the researcher will have no need to continue with further cases when the marginal utility of an additional case is considered to be low.*" (Glaser and Strauss, 1967, P85) Follow their reasoning, I choose two representative cases- one foreign manufacturer Nokia and one domestic manufacturer TCL. Foreign manufacturers differ a lot from domestic manufacturers in terms of channel strategies as they face totally different situations. It goes without saying that within foreign manufacturers or domestic manufacturers individual differences exist.

But Nokia and TCL should be representative enough as both are leaders within their own group. The cases should be able to generate insights into the industry.

4.2 Data Collection

Qualitative methodology literatures mention somewhat different assortment of data collection methods, but they cannot fall out of the following: documents, archival records, individual interviews, focus group, direct observation, participant observation, physical artifacts and action science. Considering the nature of this study, documents and individual interviews are used since the other methods were either irrelevant or not feasible.

4.2.1 Primary Data

One individual interview was conducted with Nokia and two individual interviews were conducted with TCL. Before the interviews, the interviewees received a question list to be prepared. During the interviews, the interviewer introduces the topic and then guides the discussion by asking specific questions. The interviews are of an open-ended, semi-structured and in-depth nature.

The interviewee at Nokia is the Senior VP who takes main responsibilities in Nokia's channel reform, and thus is the perfect person to interview. The first interviewee at TCL works in regional sales office and the second works in the headquarters as product manager so that their inputs can complement each other. The fact that the interviewees at TCL are the author's friends' friends shall bring the relationship closer especially in the Chinese culture context and make them willing to release some information that would be otherwise withheld.

All the interviews were conducted in the interviewee's native language. The telephone interview with Nokia lasted about 45 minutes and was in English since the interviewee is from Australia. The first interview with TCL was in Chinese and conducted through Internet phone lasting about one hour. The information of the two interviews was recorded by taking notes and transcribed afterwards with the aid of notes and memory. The transcript was sent to the interviewee for verification. The second interview with TCL lasted about two hours and was conducted through online chatting in written Chinese so the conversation was documented in its original form. (The transcripts are not attached to the Appendix but are available upon request.)

4.2.2 Secondary Data

Secondary data come from a wide range of sources- Internet news and articles, databases, company websites, company annual reports, company presentations, company internal magazines, industry reports and books. Triangulation⁷ is attempted

7 Collecting information from a diverse range of individuals and settings, using a variety of methods (Denzin, 1970)

as much as possible because *“this reduces the risk that your conclusions will reflect only the systematic biases or limitations of a specific method, and it allows you to gain better assessment of the validity and generality of the explanations that you develop”*. (Maxwell, 1941, P75) Internet news and articles are collected from May to October 2005 and the time of the articles are between 2002 and 2005. Database used is mainly Factiva. Company presentations are from the interviewees in Nokia and TCL. Besides, TCL’s company magazines are also used for information. Company annual reports are downloaded from company websites. Nokia’s annual reports are from 1994 to 2004 while TCL’s annual reports from 2003 to 2005. In addition, for all the manufacturers and intermediaries mentioned in this paper, their websites are browsed for relative information. What’s more, TCL Mobile’s former General Manager Mr. Wan Mingjian’s new book *“Systematical Strategy Wins”* is also read through for relative information. Mr. Wan was the pivotal figure for TCL’s success. The data collected from different sources are generally consistent. In case of inconsistency, the information was either verified through asking people in the relative companies or through comparing many sources and taking the dominant ones.

4.3 Quality of Research

There are two main variables to consider when judging the quality of research: validity and reliability.

4.3.1 Validity

Validity can be divided into three subgroups: construct validity, internal validity and external validity. (Yin, 2003)

Construct validity is establishing correct operational measures for the concepts being studied. There are three ways to increase the level of construct validity and thereby decrease the subjectivity: to use multiple sources of evidence, to establish a chain of evidence during the data collection, and to have key informants review draft case study report. (Yin, 2003) This study uses all three methods as mentioned in data collection section.

Internal validity is establishing a causal relationship, whereby certain conditions are shown to lead to other conditions, as distinguished from spurious relationships. Internal validity is only a concern for casual (explanatory) case studies, in which an investigator is trying to determine whether event x led to event y. (Yin, 2003). Internal validity is related with data analysis phase. Yin (2003) recommends to do pattern-matching, to do explanation-building, to address rival explanations and to use logic models in data analysis to improve internal validity. Three of the methods are applicable to explanatory studies. Only pattern-matching is also relevant to descriptive case study which this study is. Pattern-matching is comparing an empirically based pattern with a predicted one or with several alternative predictions.

This technique is used in this paper. Empirical data are identified with relevant theories under conceptual framework.

External validity is establishing the domain to which a study's findings can be generalized. (Yin, 2003) Generalization from qualitative studies has to be approached differently from generalizing from statistical samples. According to Normann (1970, P53): *"If you have a good descriptive or analytic language by means of which you can really grasp characteristics of the system, the possibilities to generalize also from very few cases, or even on a single case, may be reasonably good..... the possibilities to generalize from one single case are founded in the comprehensiveness of the measurements which makes it possible to reach a fundamental understanding of the structure, process and driving forces rather than a superficial establishment of correlation or cause-effect relationship."* Although this study is not a case study but a general qualitative study, the same rationale applies. This study thus shall be deemed adequate to reveal some fundamental characteristics of Chinese mobile phone channel structure and shed light on similar industries such as personal computers or consumer electronics which display similar dynamics.

4.3.2 Reliability

Reliability is demonstrating that the operations of a study-such as the data collection procedures-can be repeated, with the same results. (Yin, 2003) However, according to Merriam (1994, P182), because the approach of a qualitative study is developed during the study and cannot be pre-determined, the study cannot be repeated. Instead of being repeatable, a qualitative study is said to achieve the required degree reliability if the results are consistent and dependent. (Merriam, 1994, P182) To ensure that the results are dependent, the researcher should present her position, i.e. explain basic assumptions and theories, her position in relationship with the studied group, information selection criteria and how they should be described, and the social context from which the information is gathered. She should also triangulate. Finally, by writing as if someone were always looking over one's shoulder, describe in detail how information was gathered, how categories were developed and what decisions were made, reliability is strengthened further. (Merriam, 1994, P183) Yin (2003) basically suggested the same approach- to well document the procedures followed in the earlier case. The author has made an effort in meeting the above-mentioned aspects as described in the data collection section. Thus, the reliability of this study is at a moderate level.

4.3.3 Limitations

The major limitation of the study is that there is not as much primary data as the author feels it should be. Distribution information is kind of sensitive. People usually are reluctant to release this kind of information. Besides, it is not common practice for students to contact companies and ask for interviews in China. People usually will not

accept a stranger's interview unless the interviewer is introduced through friends' network.

Furthermore, interviews have the weakness of bias and possibility to be negatively affected by poorly constructed questions. The interviewee might also provide answers they believe the interviewer wants to hear. (Yin, 1994)

5. Empirical Data

5.1 Structural Changes in China's General Distribution System

As previous researches on China's channel structure took on a historical perspective and were quite descriptive, it might be helpful to summarize their founding to provide a brief background. The following description is mainly from Sherriff T.K. Luk (1997)

Under the central economic planning system before 1979, Chinese government adopted a three-tier distribution system. The system was operated by a top-down approach in the allocation of production and distribution quotas according to government plan. All trade was organized under the Ministry of Commerce, although different goods had different administrative organizations for planning and operational channels for implementation. Products from producers were transported to the first-level wholesalers in Beijing, Shanghai and Tianjin for inter-provincial sale, and to the second level in the major cities for intra-provincial sale. They were distributed to the third-level wholesaler in the municipal districts. Retailers in the cities were at the far end of channel. (Pia Polska, 1998) It could be imagined that this system was long and inefficient. Further drawbacks of this system include: state-owned commercial enterprises were only responsible for the physical movement of the goods but rarely performed value-added and differentiated marketing activities; the vertical administration systems impeded proper allocation of resources and restricted horizontal contacts among commercial enterprises at the same administration level; relationships among members within a distribution channel were administration-oriented and their interdependencies were determined not by their functions but by their legitimate positions in the administration system. What compounds the situation further were the weak infrastructure and poor purchasing power.

Structural reforms in China's marketing channels took place in 1979 corresponding to economic reforms. From 1979 to 1985, Chinese government gave state-owned enterprises more freedom in many aspects in carrying out business activities to improve operational efficiency and encouraged collectives and individuals to engage in distribution system to create multiple channels but fewer intermediate links. From 1986 to 1988, the government focused on developing horizontal links. Apart from

supplying a certain quantity of products to the central government as specified in the production contract, manufacturers could formulate a supplementary plan at their own discretion according to the market needs and sell their products directly either to state-owned wholesalers/retailers or to private sales agents/retailers at market price in the free markets of different provinces. From 1989 to 1991 it was consolidation and rectification period to gain momentum. Since 1992, in line with the goal of building socialist market economy, several new distribution reform programs were introduced, among which the most influential ones were to grant more commercial enterprises and large manufacturers greater autonomy to import and export goods and components, and to transform various administrative departments within the old Ministry of Commerce to specialized corporations in the hope that overlaps in the scope of their business will disappear, so that a clear focus on their business will enable them to improve operational efficiency and grow faster.

5.2 Structural Changes in Mobile Phone Distribution Channels

- **Stage One: National Distributor Model (1995-1998)**

There were three manufacturers in the market- Motorola, Nokia and Ericsson. Motorola came to China in 1987 setting up a representative office in Beijing and built factories in Tianjin in 1992 to produce mobile phones and other wireless equipment. Nokia set up first representative office in 1985 in Beijing and signed two joint venture agreements in 1995, one for the manufacturing of accessories and the other for the production of mobile phones. Ericsson started a representative office in 1985 in Beijing and established Ericsson China Ltd. in 1994. Each company spent a long time from first representative office to further investment to prepare themselves for the market. All three are mobile system providers. Before selling mobile phones in China, they started with selling mobile system to regional branches of the single operator- China Telecom and a few other organizations that had demand in this aspect. Before 1997, China Telecom, the state-owned company, was the only operator who took the role of developing China's telecommunication industry. When it purchased mobile systems, it also bought some mobile phones. But the mobile phones were products accompanying the mobile system, not a business of its own.

Real development in mobile phone sales started in 1997 when SIM card was separated from mobile phones. Chinese government had done a few preparations for this takeoff. One was the infrastructure network that had been built by China Telecom with the help of afore-mentioned foreign manufacturers. The second was formation of national distributors to facilitate mobile phone distribution. Among the biggest national distributors, Chinatelling⁸, PUTIAN Taili Technology Development

⁸ www.chinatelling.com Chinatelling was founded in December 1996. It has 30 branches nationwide and many retailer outlets covering Shenzhen, Guangzhou and Dongguan. It is national distributor of Motorola, Nokia, Samsung, Alcatel and DBTEL. Specifically it is strategic partner of Motorola and Nokia.

Company⁹, CellStar¹⁰ and Fortune Telecom¹¹ were formed before or around 1996. Only China Postel Mobile Communications Equipment Co., Ltd¹² was formed in 2000. Because of government support or own strong financial resources, the national distributors quickly established their widespread network. The third preparation was establishment of large telecommunication markets where individuals could open mobile phone shops. To activate exchange of products, it was a common practice for Chinese government to build large market to attract and concentrate hundreds of shops in a certain industry. All the preparations worked out well and contributed to the formation of the national distributor model (also called three-tier system).

Motorola, Nokia and Ericsson all adopted the national distributor model. The model is illustrated in Figure 1: Each Manufacturer uses a few national distributors who have access to many provincial distributors. National distributors buy mobile phones of a certain model in large volume and divide them to their provincial subsidiaries. Their provincial subsidiaries sell to provincial distributors who in turn sell to local distributors until the phones reach retail shops. National distributors' network covered major cities in each province (1st and 2nd tier cities). National distributors did all the sales work for manufacturers. Some also undertook after-sales service for manufacturer. Manufacturers focused on product development and production and provided advertising support.

9 www.china-putian.com Putian Tailli was founded in 1992 for R&D purpose by Putian Group but later started mobile phone distribution in 1996. It is national distributor of Ericsson, Philips and Alcatel. It has access to 60 regional distributors nationwide. Its parent company Putian Group is a large state-owned company that has holdings in several domestic mobile phone manufacturers and telecom companies.

10 www.cellstar.com.cn CellStar is a US-based company. The China subsidiary was founded in 1996. It is Motorola and Nokia's national distributor.

11 www.fortunetele.com.cn Fortune Telecom was founded in 1992 in Hong Kong. It is national distributor of Nokia, Motorola, Siemens, Sony, Alcatel, Hisense, Philips, NEC, Kejian, Bird and DBTEL

12 www.ptac.com.cn China Postel Company was founded in Nov 2000 in Beijing. It has 21 subsidiaries, 47 branches and 90 retail outlets by the end of 2003. It is national distributor of Motorola, Nokia, Sony-Ericsson, Siemens, Philip, Panasonic, Amoi and TCL. Its parent company is China Postel & Telecommunications Appliances, a large state-owned company.

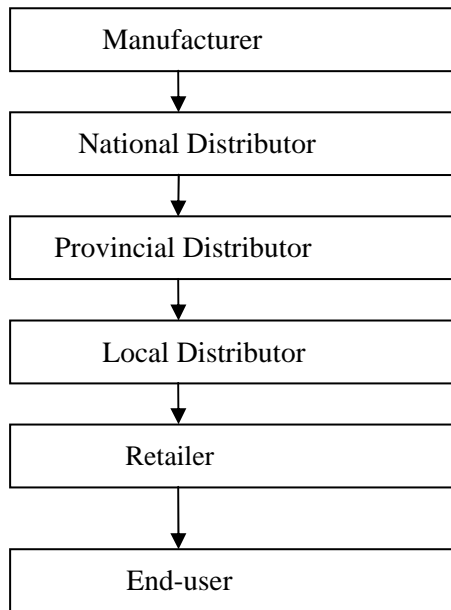


Figure 1 National Distributor Model

- Stage Two: Provincial Distributor Model (1999-2002)

During this stage, many more manufacturers entered the market. Foreign manufacturers were Alcatel, Siemens, Philips, Samsung, LG, NEC, Panasonic, and Mitsubishi. Domestic manufacturers included Bird, DBTEL, Soutec, TCL, Amoi, Haier, Konka, Hisense, Eastcom, ZTE, Panda and Kejian. New foreign entrants followed the same channel structure as that of the earliest foreign entrants.

It is worth to mention Samsung. It is quite successful with market share ranked 3rd after Motorola and Nokia most of the time. However, a large portion of Samsung's market share is from gray trade. A phone smuggled from South Korea could be several hundred RMB cheaper than the same model produced in Samsung's Tianjin factory in China. Consumers are willing to buy smuggled Samsung mobile phones despite no warranty and after-sales service because design and functionalities are loved by consumers.

Domestic manufacturers approached national distributors at the beginning. However, large national distributors were not very interested to sell many phone models for domestic manufacturers because they already had so many phone models. Even if some national distributors agreed to sell domestic manufacturers' phones, domestic manufacturer were not in priority as national distributors had long-term cooperation with foreign manufacturers. As a result, domestic manufacturers had to find a different approach. The pioneer domestic manufacturers such as Bird, TCL, Amoi etc. chose to target at 3rd and 4th tier cities and rural areas that were not covered by foreign manufacturer's channels. To reach target segments, domestic manufacturers invented

the provincial distributor model. As shown in Figure 2, domestic manufacturers sell to provincial distributors who distribute phones to local distributors within their network. Domestic manufacturers establish representative offices in the capital of each province and operation offices in each city of the province. Salespeople at those offices are responsible for supporting retailers. They help to design product lines and promotional activities of their brand for retailers, thus pulling sales at the channel end. These offices don't handle physical distribution of mobile phones at all. It is provincial and local distributors who undertake physical distribution of mobile phone to retailers. Manufacturer headquarters undertake product development and production and provide huge advertising support. The majority of domestic manufacturers followed provincial distributor model after they found it was effective.

It is worth to point out that Bird which started as a pager producer mainly used their own channels rather than distributors. Because it had established a good sales network for pager business before it started to sell mobile phones. It had large sales force to contact retailers directly. This model worked well for Bird.

Bird and TCL reached 3rd and 4th rank by market share at later part of the stage. Market share of domestic manufacturers aggregately rose from less than 3% in 1999 to 50% in 2003.

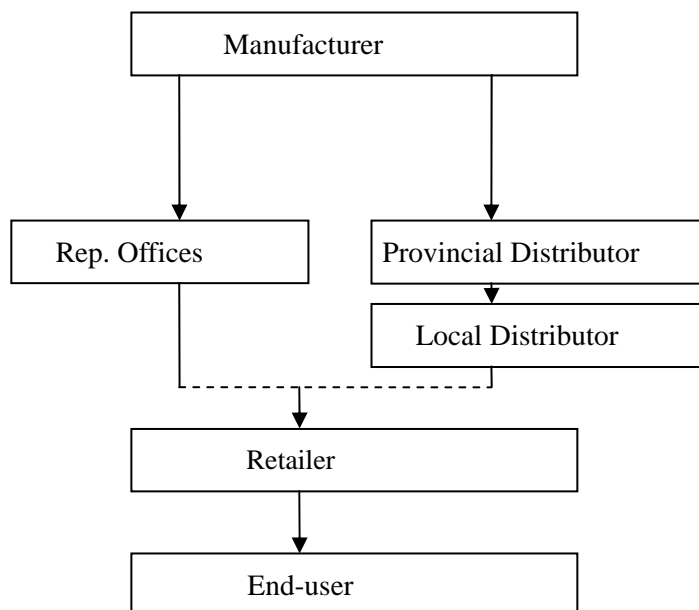


Figure 2 Provincial Distributor Model

- Stage Three: Multiple channels and Direct channel (2003- now)

China's telecommunication market keeps booming. Many more manufacturers came to market. They were Sony-Ericsson, Sagem, Kyocera, VK, CECT, Huawei, Capitel, Top, Benq, Dopod, Skyworth, Gionee and OKWAP. Still more domestic

manufacturers would like to enter the market because in February 2005 the former strict license system was loosened. As the number of manufacturers increased dramatically, competition became extremely fierce. A few manufacturers went bankrupt while others exited the market. For instance, after a few years' struggling and huge loss, Alcatel also sold mobile phone business to TCL in 2004 and Siemens sold mobile phone business to Benq in 2005. *"Faced with flagging profits, phone manufacturers have to slim their somewhat bulky distribution channel and some even go to direct sales outright"*.¹³ Generally speaking, the trend of channel structure is towards multiple channels and direct channel.

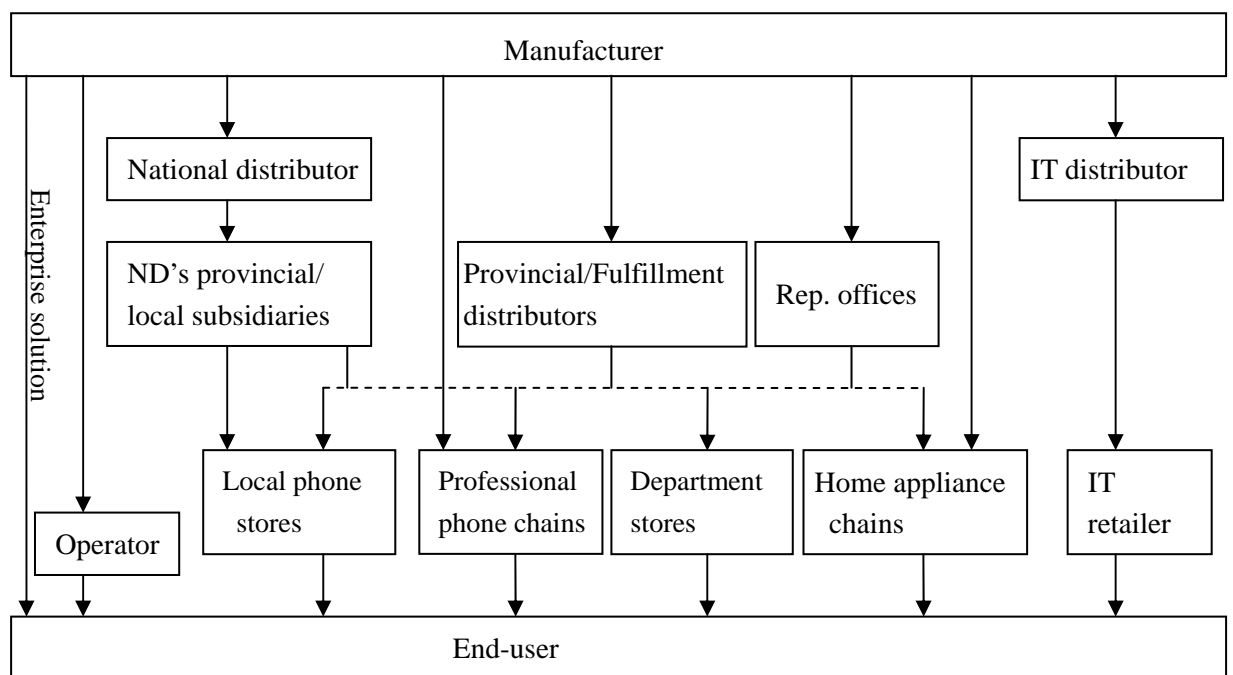


Figure 3 Multiple channels and Direct Channel Stage

Many foreign manufacturers reformed their channel structure during this stage. Almost all foreign manufacturers began to supply chain retailers directly. But they had to maintain a balance between national distributors and chain retailers. The result was that foreign manufacturers entered into tri-lateral agreements with national distributors and chain retailers. In contrast, domestic manufacturers simply signed contracts directly with chain retailers. Under the general trend of multiple channel and direct channel, different manufacturers have different focus though. Korean and Japanese manufacturers still use national distributors, resorting to good brand and products and settling on high-end market. Motorola is using national distributors and 4 regional distributors. Its focus is on operators and enterprise accounts. Inspired by Dell's direct sales solution Motorola founded a department called Enterprise Solution in 2001 that sold directly to company customers¹⁴. Nokia and Sony-Ericsson is

13 www.global.factiva.com File No. SC1W000020040510e05a00006

14 <http://www.gog.com.cn/jqpd/pd02006/ca298796.htm>

moving towards the direction of fulfillment distributors. Fulfillment distributor named by Nokia is basically the same as provincial distributor of domestic manufacturers. These distributors serve as physical distribution and financing platform while manufacturers' sales force takes full responsibility in contacting retailers. Due to competition from domestic manufacturers, Motorola and Nokia launched many low price phones, targeting at all segments from high-end to low-end. Low-end market is mainly 3rd and 4th tier cities and countryside where domestic manufacturers were strong. Because foreign manufacturers changed channel strategy, earlier domestic manufacturers suffered from great loss since 2004. Newly-entered domestic manufacturers learned lessons from that and took different approaches. For instance, Lenovo uses multiple channels and Dopod focuses on operator.

There is some trend for vertical integration. *“Zhongyu, a leading phone retailer in China, announced mid-April that it will soon manufacture self-branded phones by injecting around CNY 200 million in infrastructure construction. Zhongyu currently has 1,500 chain stores across the country.”*¹⁵ In comparison, *“as early as late 2003, many homebred phone manufacturers such as Konka and Soutec began to abandon distributors and open direct ships nationwide”*.¹⁶

Along with the trend of direct channel, national distributors are under pressure of disintermediation. To compete with provincial distributors, some started to strengthen their provincial/local subsidiaries to compete more flexibly with provincial distributors. To compete with chain retailers, some of them forward integrated into retail. Under the trend of multiple channels, IT distributor Digital China rose because it reached a different segment.

On the retail level, chain retailers became powerful players. There are three types of chain retailers: home appliance chain stores, professional phone chain stores and department stores/supermarkets. *“Home appliance retailers like Gome and Dazhong play a pivotal role in phone distribution network.”*¹⁷ These stores have large stores and huge capital. They buy in large volume and sell at cheap prices. The biggest home appliance chains are Gome, Suning and Yongle. *“In addition, professional phone chain stores became available now, which greatly facilitates manufacturers to manage their sales terminals”*¹⁸. The most well-known ones are Zoomflight(中复电讯), Zhongyu(中域), Xieheng(协亨), Di Xin Tong(迪信通) and Longyue Telecom(龙粤). Some of the professional phone chain stores are regional while others are national. In 2003 sales at home appliances chains took 10.8% market share and sales at professional phone chains took 38.6%. On the other hand, China's mobile phone market is still fragmented with more than 35,000 retail outlets in 20,000 cities. While decreasing in number, the local phone stores in telecommunication markets still exist

15 www.global.factiva.com File No. SCIW000020040510e05a00006

16 www.global.factiva.com File No. SCIW000020040510e05a00006

17 www.global.factiva.com File No. SCIW000020040510e05a00006

18 www.global.factiva.com File No. SCIW000020040510e05a00006

to a certain degree.

Another feature of this stage is that operators are increasing their influence in mobile phone distribution. Currently there are two mobile network operators in China – China Mobile and China Unicom, both of which are state-owned companies. China Unicom was established in July 1994 to break the monopoly of China Telecom, the single operator in China for more than 40 years. However, China Unicom's scale was small and the competition intended was not brought to the market. As a result, in 1999, Ministry of Information Industry split China Telecom into China Telecom (fixed lines), China Mobile (mobile network) and China Satcom (satellite communication). Old China Telecom's paging service was merged into China Unicom. Government also issued operator licenses to China Netcom, China Railcom, and China Jitong. Then there were 7 operators in the market, each specializing in different businesses. At the end of 2001 China Telecom was divided further into south and north. The north part was merged into China Netcom. China Jitong was also merged into China Netcom. This ended in 6 operators- China Telecom, China Netcom, China Mobile, China Unicom, China Satcom and China Railcom.¹⁹ Among them China Mobile and China Unicom are specialized in Mobile network. China Mobile operates GSM network while China Unicom operates GSM and CDMA network. With 3G licenses pending, there has been a lot of discussion about reorganize the operators. No matter how the government is going to reorganize the 6 operators, there is a common opinion that China Telecom and China Netcom will have a share in the mobile network business. China Telecom has been trying to regain mobile business ever since the split in 1999. China Netcom has already started investing in GSM network.

For GSM phones, China Mobile launched one RMB phone in 2003. Those mobile phones were manufacturer brands. Subscribers could have the phone at 1RMB after they signed a subscription contract agreeing to use a certain amount of service each month. Later China Mobile launched made-to-order phones, which were co-branded with manufacturers. In 2004 China Mobile founded Topssion, a terminal equipment sales company with ZTE, Eastcom, Bird, Huawei and Digital China. For CDMA phones, as China Unicom is the only operator of the CDMA network, it played a major role in distribution CDMA phones bundled with its service.

5.3 Nokia's Channel Strategy and Channel Structure

Nokia entered China in 1985 and started mobile phone production in China in 1995. Along with mobile phone popularity since 1997, Nokia gradually established itself as market leader in Chinese market. Since January 2004 Nokia has been No. 1 market share in China. China is also an important market to Nokia. In 2004 net sales from China accounted for 25% of its global net sales²⁰.

¹⁹ <http://www.cas.ac.cn/html/Dir/2002/10/31/0836.htm>

²⁰ Nokia Annual Report 2004

“Most of our mobile device business derives from sales to operators, distributors, independent retailers and enterprise customers. However, the percentage of the total sales volume from each channel varies by region.In China, handsets are sold almost solely through the retail channel...”²¹

Nokia’s channel strategy and corresponding channel structure can be divided into three stages shown in Figure 4.

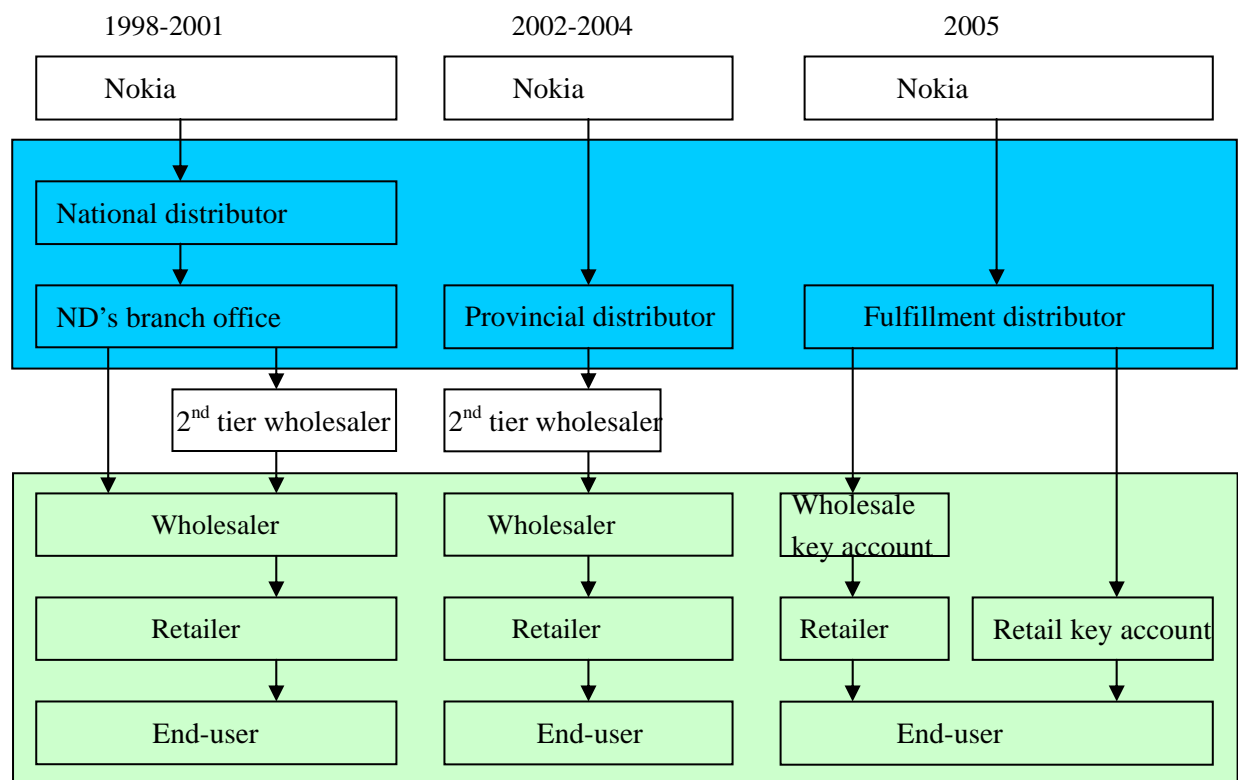


Figure 4 Nokia’s Channel Structure

22

From 1998 to 2001, Nokia used the national distributor model. *“When Nokia first entered Chinese market, we went for the easy way- to use the national distributors. The national distributor has to understand the market very well. They do all the sales. Actually this is the way Nokia entered all the markets globally. Usually Nokia has one account in a country. But as China is big, we end up with 8 national distributors in 2001.”²³* It goes without saying that a certain degree of conflicts existed between the national distributors. To stop conflict, Nokia offered exclusiveness to national distributors based on phone models. At that time, Nokia completely relied on national distributors. Nokia had 3 regional offices (Beijing, Shanghai and Guangzhou) to

²¹ Nokia Annual Report 2003. In the Asia-Pacific area, distributors and retailers account for more than half of the total sales volume. In Europe, Middle East and Africa, the distribution is split approximately half and half between operators and the other channels. In Latin America and North America, operator sales represent the major share.

²² Colin Giles's presentation August 2005 India

²³ Interview with Colin Giles

support the national distributors. Among the 8 national distributors, some were foreign, others were domestic and still others were of mixed ownership. This strategy allowed Nokia quick access to established distribution networks, covering 1st and 2nd tier cities where people had the purchasing power at that time. The structure did have drawbacks. According to Cai Yun, Chief Communication Officer of Nokia China, *“this channel structure is long and consumes margin. What’s worse, flexibility is low and response slow.”*²⁴ Most of the national distributors had state-owned origin. They tended to rely on inherited resources and lack the ability of developing new accounts.

China’s mobile market changed very fast. When it came to 2001, the market landscape was very different. Mobile phones were no longer luxury. People in 3rd and 4th tier cities and rural areas could afford mobile phones. But Nokia’s national distributors had limited capability to develop in these areas. In 1st and 2nd cities, Nokia faced strong competition from Motorola. Nokia’s market share was dropping between 2001 and 2003. When Colin Giles came to China from Nokia Australia in 2001 as Senior VP in Customer and Market Operations, he quickly found the solution was to learn from domestic manufacturers. Channel strategy shifted from National Distributor Model to Provincial Distributor Model. The number of national distributors was reduced to 3 (China Postel, CellStar and Fortune Telecom)²⁵ while the number of provincial distributors increased from 20 in early 2003 to nearly a hundred at the end of 2003. In the beginning provincial distributors took full responsibilities in sales for Nokia the same as national distributors. To avoid competition between national and provincial distributors, Nokia gave different phone models to them. Nokia also learned from domestic manufacturers to send salespeople and promoters to retailers’ premises. Nokia increased sales force to 6000 people and added one extra regional office in Chengdu. What’s more, Nokia moved sales people from four regional offices to 3rd and 4th tier cities. Provincial distributors helped Nokia to cover 3rd and 4th tier cities better. Market share was regained in 2004. The consequent channel structure is shown in Figure 3 middle.

The above provincial distributor model was a transitional step. From March 2005 Nokia started second-round reform in channel structure by launching Fulfillment Distributor Model. In this model, fulfillment distributors act as physical distribution and financing platform while Nokia’s branches and representative offices take full responsibility in sales.²⁶ A tri-lateral contract is signed among Nokia, a fulfillment distributor and a retailer. The reason behind it is that since Nokia has got 6000 sales force, it prefers to do the sales itself. In this way, Nokia has better control downstream. Nokia’s salespeople visit retailers frequently, ensure faster supply together with fulfillment distributors, and provide brand support, marketing fund, marketing plans

24 <http://past.people.com.cn/GB/it/50/145/20030117/909854.html>

25 Nokia’s remaining national distributors transformed themselves accordingly. Take China Postal for example, under its headquarters were 10 regions and 64 branches. The branches not only distributed phones from headquarters but also could obtain business as provincial distributors from Nokia upon approval from Headquarters.

26 This model is actually the same as domestic manufacturers’ way of cooperating with provincial distributors that we will present in TCL’s channel strategy. Nokia learned this form domestic manufacturer but gave it a different name.

and necessary trainings for specific retailers. Nokia resorts to its strong brand power to influence the retailer and to get desirable display section in important stores. Now Nokia has direct contact with 30, 000 retailers in 400 cities. This model was put into practice in Hubei province first and now applied to several selected provinces. For instance, in canton province provincial distributors were replaced by four fulfillment distributors, some of which were transformed from provincial distributors. Sales in Canton increased by 40% after implementing this model.

Apart from the above two distinctive reforms, Nokia experimented direct supply to retailers as well. It chose a few direct retailers in Shanghai in 2001 and had some good results. In 2002 Nokia established a direct retail program team responsible for direct supply to large retailers. In 2003 Nokia signed regional direct supply contracts with Di Xin Tong, Xieheng, Gome and Suning. In 2004, Nokia signed national direct supply contract with Gome. According to He Honglue²⁷, South China Sales Manager at Nokia, Nokia launched two additional programs on the retailer level in 2005: one is called Blue Dragon- to develop 20 direct retailers nationwide; the other is called Golden dragon- to establish more authorized stores to maintain brand image. There were 170 Nokia professional centers until 2004.

Nokia pursues operator channel too. According to He Honglue²⁸, to avoid conflict between operator and other channels, Nokia tells their distributors to buy less of the model that an operator has ordered two months beforehand. From past experience, there is not much conflict between distributors and operators because Nokia has a wide variety of popular models at different price levels. Besides, distributors like the models that operators have ordered because those models are easy to sell due to operator's promotion.

Nokia realizes that with market development, consumer needs become sophisticated and diversified. Sub-segmentation is thus necessary. Colin Giles once said, "Our channel strategy is to match competent channel partners with our product positioning to reach the target segment". For example, Nokia 9210c, a high-end phone used Digital China, a famous IT distributor. Nokia N-Gage, the gaming phone was available throughout major retail, game-specific and video game outlets, in addition to usual mobile phone delivery channels.

5.4 TCL's Channel Strategy and Channel Structure

TCL Corporation, founded in 1981, is a consumer electronics manufacturer in China. Products include multimedia, telecommunication, white goods, lighting, electronics and computers. Currently multimedia (TV, video and audio systems) constitutes the largest business unit in TCL with a revenue share of 63.12% and telecom comes second at 12.9%. TCL Mobile Communication Co. Ltd. was established in 1999.

27 http://news.ccidnet.com/art/1032/20050322/226413_1.html

28 http://news.ccidnet.com/art/1032/20050322/226413_1.html

TCL's channel strategy and channel structure can also be divided into three stages shown in Figure 5.

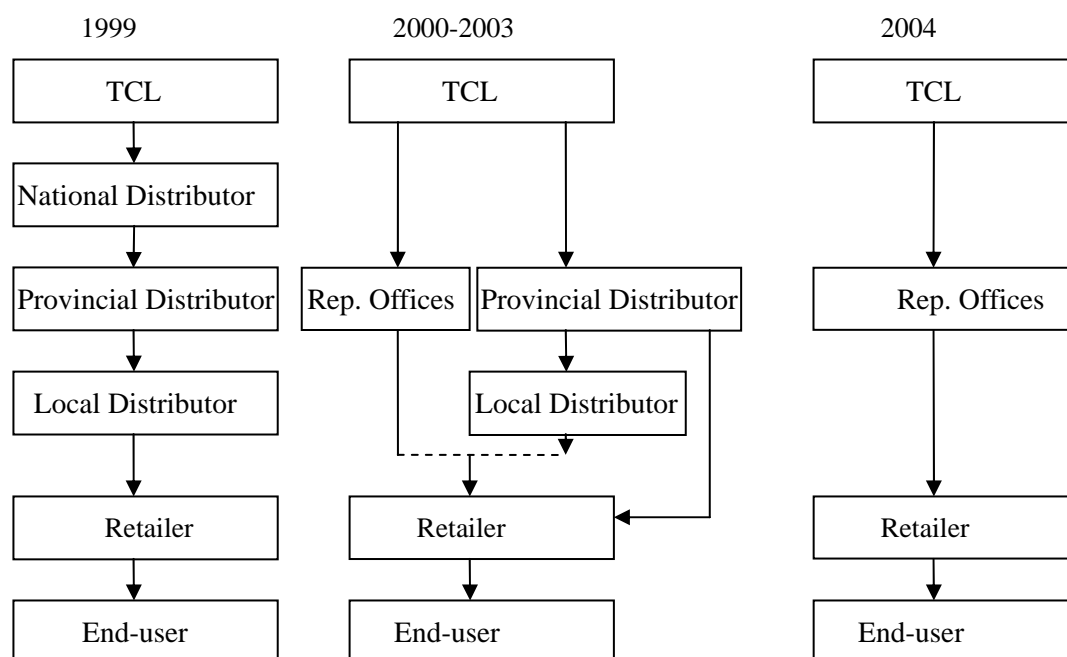


Figure 5 TCL's Channel Structure

According to Wan Chigang, TCL Mobile copied foreign manufacturers' National Distributor Model in the beginning. However, problems appeared. National distributors handled many brands at the same time, some of which were used for volume goal and some of which were used for profitability goal. TCL did not have as strong control as that of foreign manufacturers on national distributors and fell into the former category. Phones were sold at very low prices to some remote distributors which didn't deal in TCL mobile phones, so the national distributors could obtain more rebates based on volume from TCL and the channels were messed up. As a result, TCL soon abandoned the first strategy and created Provincial Distributor Model.²⁹

Under Provincial Distributor Model, a representative office was established at the capital of each province.³⁰ TCL now has 30 representative offices nationwide and has access to more than 1300 agents and 20,000 outlets in China.³¹ The representative offices were responsible for channel management and promotion at retailers. There was no physical flow from representative offices to provincial distributors. TCL's salespeople visited retailers frequently to build up relationship because

²⁹ General distributors are still used to a certain extent. As stated in TCL's annual report 2003, they are used through strategic cooperation. In 2001, China postal signed a 100k handset contract with TCL for a certain model

³⁰ According to Feng Li, during the switching process sales network of mobile phone share the same offices as that of TV sales except for new people were recruited to take care of mobile phone sales. When mobile phone sales grew to a large scale in 2002, a separate network of offices was established for mobile phones sales.

³¹ TCL Company Presentation

recommendation by the retailers did significantly influence purchasing decision especially in 3rd and 4th tier cities and rural areas where consumers were not so sophisticated. TCL also sent their own promoters to retailers' premise to carry out all kinds of promotional activities. The number of promoters in each province could amount to hundreds. Distributors' functions were financing and physical distribution. Each province had two or more provincial distributors to keep a desirable degree of competition. Provincial distributors bought goods from TCL headquarters and distributed them to local distributors and local distributors distributed the phones further to retailers. Take Beijing for example, in 2003 TCL had three provincial distributors-Hongbo(鸿波), Hai Xia Xing Shi(海峡兴事) and Huan Yi Tong (环亿通). Beijing was divided into 9 districts and there were altogether 25 local distributors. Each provincial or local distributor was responsible for one or a few phone models. Provincial distributors also had the problem of cross-selling, but to a much less extent. This channel strategy contributed a lot to TCL's most fast-growing period from 2001 to 2003. In 2002 TCL's domestic market share rose to 7% (ranked 3rd after Nokia and Motorola) and in 2003 reached climax 11%. Some bestseller models such as 3188 had such a high demand that the distributors paid in cash and waited at the gate of TCL factory for the phones. But this also brought the problem of poor quality because the factory was in crazy production to meet the demand but ignored QA. The consequent repair rate of TCL phones was as high as 6% compared with foreign manufacturer's average 2%. TCL has taken measures to improve its image in quality but this surely will take a long time. Despite strong growth in volume, rising overhead due to large number of salespeople plus substantial advertising costs resulted in decreasing gross margin for TCL.

Manufacturers were under pressure of big chain retailers to buy directly. In mid 2003, TCL announced that one of its three provincial distributors in Beijing was going to supply big retailers like Di xin tong, Dazhong, Zoomflight and Gome which had been supplied by local distributor Jia Zhi Shi Dai (佳智时代). Jia Zhi Shi Dai was really upset about that. But that was only the beginning of shortening channels.

In 2004, the market situation started to deteriorate. Many more manufacturers came to market. The market encountered excessive supply. Nokia and Motorola stroke back by introducing entry-level phones and precipitating launch of new models resorting to their powerful R&D, making the life cycle of mobile phones shorter. Most domestic manufacturers lost money. TCL's market share shrank to 5.85%. To turn around, TCL decided to strengthen R&D³² and restructure channels. The strategy is to skip provincial and local distributors and to supply big retailers directly. Under the new strategy representative offices will undertake physical distribution. Phones are dispatched from headquarters to representative offices and then from representative offices to retailers. This strategy was tried in Jiangsu Province and now applied nationwide. Admittedly, distributors will remain in special segments or in fragmented

32 To strengthen R&D as well as facilitate international expansion, TCL started a joint-venture T&A with Alcatel in September 2004 and TCL transformed T&A into its wholly-owned subsidiary by a share swap with Alcatel in June 2005.

areas to serve the local stores.

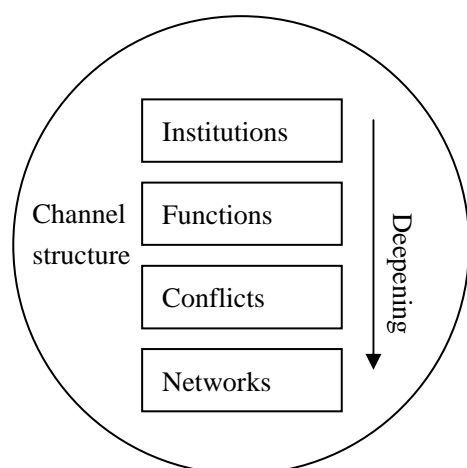
TCL experimented opening its own retail stores. In 2002 it opened 40 stores in Shenzhen. The sales volume turned out to be few. It realized that manufacturer flagships were for building brand rather than selling products.

According to Wan Chigang, another important channel is operator, but TCL has not been able to obtain many orders from this channel. Only in April 2005 TCL got an order from China Mobile Canton Branch for 20k of its Q515. Most of operator orders went to foreign manufacturers. The high return rate and unfavorable after-sales services have made domestic manufacturers lose ground to foreigners. Not only China Mobile but also most Chinese consumers are unwilling to use home-branded phones. According to CCID Consulting, among the consumers who have bought domestic mobile phones, only 6.08% of them will choose domestic brand again when replacement need rises.

6. Analysis

During the following analysis, I usually refer back to the data presented in empirical part because in a qualitative study like this, it is somewhat hard to totally separate analysis from data.

6.1 What is the evolvement of mobile phone channel structure?



6.1.1 Institutions

6.1.1.1 Manufacturers

Types of manufacturers

There are many ways to categorize manufacturers. By business focus, we can divide them into telecom-focused, diversified and mobile phone-specialized. Nokia, Motorola, Ericsson, Alcatel, Sagem, Eastcom, ZTE, Capitel and Huawei fall into the

first category. Siemens, Philips, Samsung, LG, NEC, Panasonic, Mitsubishi, TCL, Amoi, Haier, Konka, Hisense, Lenovo, Benq, Kyocera belong to the second. Sony-Ericsson, Soutec and Topod are the third type. Telecom-focused manufacturers are generally more successful than the other two types of manufacturers. A few reasons explain this. Telecom-focused manufacturers have strong R&D capability to support wide product lines in different segments so they enjoy larger market share. In addition, they have good connection with infrastructure network to gain business from operators. Consumer's perception on telecom-focused manufacturers is more positive because these manufacturers are regarded as industry experts. Last but not least, telecom-focused manufacturers entered Chinese market very early. They enjoyed first mover advantages such as higher brand recognition, more positive brand image, more customer loyalty and longer market experience, which contributed to Nokia and Motorola's market leader positions. On the other hand, diversified manufacturers are usually those who have established themselves in consumer electronics and home appliances. In the beginning they entered the mobile phone market because they saw big growth and profit potential of the sector and they aimed to make successful brand extension. Brand equity is their strength. But later the major driver of diversified manufacturers entering mobile phones business is 3C integration (computer, communication and consumer electronic). Computer or consumer electronic manufacturers are deploying strategically in 3C areas to prepare for future integration of three types of terminals. This explains why domestic home appliance manufacturers such as Changhong, Chuangwei and computer manufacturer Lenovo, Benq rush into mobile phone market after loosening of government licenses despite the fact that the market was crowded with many manufacturers and making profit becomes harder and harder. This also explains why traditional consumer electronic manufacturers such as Philips, LG and Panasonic choose to remain in the market but with a limited number of phone models. As to the third type of manufacturers, they are late entrants and have their own strategies based on forerunner's lessons. Sony-Ericsson inherited brand equity from Sony and Ericsson and is focusing on music and entertainment while Dopod is focusing on operators. Both of them are doing well. But it is still hard to predict the future of mobile phone-specialized manufacturers. It could be risky to focus only on mobile phones. The future of this type of manufacturers depends on how much they can adjust themselves towards the future direction of the industry.

By origin, we can divide manufacturers into Western (Nokia, Motorola, Alcatel, Siemens and Philips), Asian (Samsung, LG, NEC, Panasonic and Mitsubishi) and domestic (Bird, DBTEL, Soutec, TCL, Amoi, Haier, Konka, Hisense, Eastcom, ZTE, Panda and Kejian). Each group has different strengths and weaknesses. Western manufacturers have strong brands and R&D but they are poor at localization in product design and distribution. Asian manufacturers also have strong brands as they are diversified manufacturers successful in consumer electronics. Asian manufacturers are good at product design. While mobile phones made by Western manufacturers are mostly neutral, those made by Asian manufacturers are elegant, fashionable and has

feminine features and colors. As a result, they are quite popular among young people and women. Asian manufacturers' distribution is similarly weak as western manufacturers. Domestic manufacturers are good at local distribution and catering product design to local taste. Their fatal problem is quality. Among the top 5 manufacturers, three types of manufacturers exist and the rank varies from time to time. This indicates how their strengths and weaknesses play against each other.

By positioning, manufacturers can be divided into low/middle-end, middle/high-end and all-segment. Western manufacturers used to target at middle/high-end segments, which is also reflected by their channel structure covering 1st and 2nd tier cities. After domestic manufacturers targeted at low/middle-end segments in 3rd and 4th tier cities and countryside³³, Western manufacturers gradually realized that the low-end market was also attractive in terms of growth and volume. Nokia recognizes generally two segments in China- value and volume, both are strategically important. Nokia's No.1 market share in 2004 was to a large extent contributed by mobile phones under 1000RMB. Motorola launched mobile phones as low as 320RMB recently in China with the hope to take Nokia off the No.1 throne. Asian manufacturers like Samsung are not interested in competing for the price. They prefer to settle on middle/high-end segment. It is meaningful to mention product lines here. In order to target at all segments, it is demanding for manufacturers in financial, R&D, production and marketing resources. Western manufacturers like Nokia and Motorola have the resources and commitment to do it. They can have many popular models simultaneously in each segment. When it comes to distribution, this gives them extra space to play with distributors such as differentiating models to different distributors or withholding a certain model from a certain distributor. Asian manufacturers do not have the commitment to invest that much in Chinese market. They instead focus on few in number but excellent in product. Their product appearance and functionalities are liked by consumers very much. In comparison, it is very common that a domestic manufacturer comes up with a blockbuster and become temporarily successful. How to constantly come up with blockbusters is a question. At the time of the blockbuster, sales explode; the manufacturer, its distributors and retailers are all happy. Consequently the sales goal set for distributors and retailers the next year has to be much higher. But there are not so many blockbusters the next year. Under pressure, distributors and retailers have to take unusual measures to increase volume, usually low price. After all, they can make money from other phone brands, from selling operator's SIM card and even from selling accessories. That leads to the problem of cross-selling and messed-up channels for domestic manufacturers. Thus, sustained and well-planned product lines supported by financial, R&D, production and marketing resources are essential in increasing market share.

Number of manufacturers

The number of mobile phone manufacturers has been increasing all the time. In the first stage, there were only 3 while in the second stage it exploded to 23 and in the

³³ The majority of domestic manufacturers target at low/middle-end segments with a few exceptions such as Dopod

third stage it doubled. Ministry of Information Industry so far has given out 30 GSM phone licenses and 19 CDMA phone licenses. In February 2005 the former strict license system was loosened. Many diversified domestic manufacturers rush to get hold of a manufacturer license. They have been OEM manufacturers or at least been preparing for mobile phone production for some time in order to complete 3C integration strategic deployment.

As more and more manufacturers entered the market, huge surplus existed. Manufacturers like Bird and TCL found outlet for surplus in less sophisticated overseas markets such as Russia and India. But their worsening market position in China is something they have to cope with.

- There are three ways to categorize manufacturers: by business focus- telecom-focused, diversified and mobile phone-specialized; by origin- Western, Asian and domestic; by positioning, high-end, middle-end, low-end and all segments. Each group has its own strengths and weaknesses.
- The number of mobile phone manufacturers has been increasing ever since 1995. There is huge surplus in the industry.

6.1.1.2 Distributors

Types of distributors

We distinguish national distributors, provincial/fulfillment distributors and local distributors. National distributors are mainly state-owned companies. They have a nationwide network covering 1st and 2nd tier cities. Their strengths are large scale and strong financial resources. They can buy exclusively a certain phone model from a manufacturer. They have the capability to carry large inventory and thus share manufacturers' risk. Their weakness is poor ability to develop new accounts locally.

It is worth to mention IT distributor like Digital China as national distributor. It joined distribution of mobile phones in 2003. IT distributor reaches a different segment from traditional national distributor. Digital China has a national network for computers and IT-related products. IT distributor being part of mobile phone channel indicates the need for sub-segmentation from manufacturers' side. It is also the IT distributor's own need to prepare for 3C integration.

Provincial/fulfillment distributors are private companies. They are strong in their own territory. The rise of provincial/fulfillment distributors is attributed to domestic manufacturers. From the second stage provincial distributors were no longer national distributors' extensions. They buy mobile phone directly from manufacturers rather than have national distributors stand between them and manufacturers. Provincial/fulfillment distributors' functions differ according to manufacturer's channel design. We will discuss this later in detail in next section. As provincial/fulfillment distributors reach 3rd and 4th tier cities better, they bring threat

of disintermediation to national distributors.

Local distributors are facing a decreasing living space in the market. After the rise of provincial distributors and chain retailers, national distributors and provincial distributors tend to sell directly to retailers. Local distributors are dis-intermediated most in 1st and 2nd tier cities. Their living space is to serve retailers in 3rd and 4th tier cities and countryside where market continues to be fragmented.

Number of distributors

The number of national distributor is fairly stable. The reason is that it is not easy to establish a nationwide mobile phone distribution network in a short time and it is not easy to eliminate any of the existing national distributors either. National distributors still possess a lot of financial and network resources and they can adjust themselves when market conditions change. The number of provincial distributors is still increasing and the number of local distributors has gone through increase and decrease.

- National distributors have lost dominant position to provincial/fulfillment distributors because of their respective strengths and weaknesses in relation to environment changes.
- IT distributor being part of mobile phone channel indicates the need for sub-segmentation from manufacturers' side.
- Local distributors will continue to survive in 3rd and 4th tier cities to serve the fragmented market.
- The number of national distributor is fairly stable. The number of provincial distributors is still increasing and the number of local distributors has gone through increase and decrease.

6.1.1.3 Retailers

Types of retailers

There are four types of retailers- local stores, professional chain stores, home appliance chain stores and department stores/supermarket. Local stores were dominant in the early stage of mobile phone distribution. They were usually run by individuals. The advantage of concentrating them in one market was to form an industry platform where shops competed actively and market information flowed quickly. Also consumers could shop around and compare prices without visiting scattered shops. The strengths of local stores were flexibility and personal relationship with consumers. They could adjust retail price freely according to market situation. They usually developed good relationship with old customers to bring new customers. Their weakness was credibility. Consumers could not count on that the stores would always be there. What's worse, some stores dealt in fake mobile phones, old phones refurbished as new phones and smuggled phones.

Chain retailers rose in the second stage and became dominant in the third stage. Their strengths are low price and credibility. Chain retailer's prices are in fact not necessarily lowest because local store can get phones from unauthorized channel. But chain retailers' credibility makes them stand out from local stores. Credibility comes from chain retailers' brand investment and large scale. Professional chains basically used the same strategy as home appliance chains. What they differ is scale and scope. Professional chains could be provincial or regional while home appliance chains are national. Home appliances chains have more financial and marketing resources. They compete not only with other retailers but also with distributors, for they want to buy directly from manufacturers. With big stores, strong promotion, low prices, they bring the most challenge to the traditional channels. Home appliance chains like Gome and Suning don't rely on rebates from manufacturers to make money but on "real estate". The charges for manufacturers' products to be on shelf or on special display are astronomical. During holidays and festivals, manufacturers have to send promoters to chain retailers' stores and provide fund for promotional activities the retailers carry out.

Number of retailers

The number of local store was numerous in the first stage. After the rise of chain retailers, the number of local stores started to decrease. The number of home appliance chains is fairly stable as it is not easy to establish a large national chain retailer. Professional chain stores are increasing fast regionally. Some came from transformed distributors.

As chain retailers' stores were mainly in 1st tier cities, local stores still had power in rest cities. But now chain retailers are expanding into 2nd and 3rd tier cities. Therefore we will see further decrease in the number of local stores in these cities. However, the expansion of chain retailers is ultimately limited. In smaller cities, towns and countryside, the local markets are not large enough to justify a large-scale store. Local stores will continue to be active in these markets. As a result, different types of retailers actually reach different segments- value and volume segments.

- Local stores were dominant in the early stage of mobile phone distribution.
- Chain retailers rose in the second stage and became dominant in the third stage. Professional chains basically used the same strategy as home appliance chains. What they differ is scale and scope.
- We will see further decrease in the number of local stores in 2nd and 3rd tier cities. However, the expansion of chain retailers is ultimately limited because in smaller cities, towns and countryside, the local markets are not large enough to justify a large-scale store.

6.1.1.4 Operators

Types and number of operators

The operators can be divided into GSM and CDMA network. GSM is dominant and China Mobile is much stronger than China Unicom. That's why currently there is a hot discussion about reorganization of China Unicom. The reorganization is about whether China Unicom is going to sell its GSM network to China Telecom so it can concentrate on CDMA network. However, the biggest problem is GSM network is China Unicom's major revenue source. As to the number of operators, it is predicted that China Telecom and China Netcom will enter market with GSM network, resulting in 4 mobile operators. Afterwards, China Telecom, China Netcom and China Mobile could upgrade their network into 3G. The real outcome will depend on government decision.

No matter how the number and organization of operators are going to change, one thing is for sure-operators will have more and more influence in mobile phone distribution. First, with expansion of value-added services and forthcoming 3G, it is necessary for operators to control terminal functions and sales. Second, operators have resources to undertake phone distribution. Their sound channel network reaches even the smallest towns.

To the manufacturers, this could be both an opportunity and a challenge. The advantages of selling to operators are lower marketing expense, lower pressure of distribution and large orders. The flip side of the coin is loss of own brand and channel power. As the advantages outweigh the disadvantages, manufacturers all actively pursue sales to operators. Although foreign manufacturers won the made-to-order phones, domestic manufacturers grabbed a share in China Mobile's terminal sales company Topssion. Domestic manufacturer Dopod even went for operator from the very beginning. With forthcoming 3G, we see biggest opportunity for network equipment manufacturers such as Huawei and ZTE. They have been working with the operators for a considerable time in preparation for 3G and accumulated related technologies. It is likely for operators to require a total product offering including both infrastructure and terminals from them. Thus it is no surprise for Huawei to enter mobile phone business recently.

- Operators are having more and more influence in mobile phone distribution. To the manufacturers, this could be both an opportunity and a challenge.

6.1.2 Functions

Generic channel flows are not very useful in analyzing the channel structure of mobile phones. Because it is hard to explain why a certain flow has to go through a certain channel member. For example, why does a physical flow has to go through a national distributor rather than go directly to a provincial distributor or a retailer? Thus here we focus on what indispensable functions have been performed by a certain channel member and whether these functions could be performed more efficiently by someone else.

How the functions are divided among channel members depends on the official and unofficial agreements among manufacturers, distributors and retailers. Theoretically the way they divide functions is based on who can do what most efficiently. This generally complies with reality. In the first stage manufacturers just started phone production. They needed to concentrate on product development and production. A natural choice was to let their distributors assume physical distribution and sales functions. In this way, contact efficiency was achieved. Contacting a few national distributors was enough to reach a considerable volume goal. Manufacturers got cash back quickly from national distributors which could be reinvested into new product development to sustain growth. Here national distributor's role was not so much about the traditional sorting function because mobile phones were not commodity.

When it comes to the second stage, environment changes and national distributors were no longer efficient in performing assigned functions. Their ability and proactiveness to develop new accounts in emerging 3rd and 4th tier cities were low. They used to sit in the office and make phone calls to get business done. Manufacturers felt that they themselves could perform sales functions more efficiently than national distributors did. Thus manufacturers shifted the functions performed by national distributors to themselves. This is quite unusual since most theory states that outsourcing part of the functions to who specialized in it would be more efficient. But the key is national distributors were not necessarily more efficient. They had the common weakness of state-owned companies. In the Provincial Distributor Model, manufacturers increased number of contacts since they had to contact many provincial distributors. They also increased direct contacts with retailers and assumed promotion functions. Physical distribution was left to provincial distributors. Ultimately, Bird and TCL shifted more functions to themselves. They undertook both sales and physical distribution.

Function analysis helps us to predict whether national distributors are eventually going to be eliminated or not. The answer is probably not. National distributors still have the advantages of financing, inventory carrying and risk sharing. They will survive if they can innovate in re-dividing functions between themselves and upstream and downstream partners and try to use their strengths to perform assigned functions most efficiently. For example, national distributors were involved in deals between manufacturer and operator to provide a distribution platform in the case of Dopod. Other innovation aspects include value-added service, after-sales service and information providing etc.

Retailer' functions are time utility, place utility, assortment and service. Local stores and chain retailers are approximately the same in time and place utility as they usually open at shopping center and telecommunication market. What makes chain retailers stand out are wide assortment, credibility and after-sale service. This explains why chain retailers became more and more popular. Chain retailers pushed to buy directly

from manufacturers. As functions could be shifted but not eliminated, they had to divide distributors' functions between themselves and manufacturers.

As to operators, they focused on managing networks and their services. Mobile phones did not go through operator channel in the past. It was the retailers who sold SIM cards with mobile phones. In order to compete for consumers, operators rewarded retailers based on SIM cards retailers sold. But this is changing now. Operators start to undertake functions of mobile phone sales.

Different manufacturers have different preference with regard to dividing functions in the channel. Motorola and Asian manufacturers basically hold that manufacturers should concentrate on product development and production. So they go for national distributors and only adapt to a limited degree to flatten the channels. Nokia and Sony-Ericsson, on the other hand, think national distributors are not adequate to reach all segments of the market. So they decide to assume sales functions themselves. Labor is cheap in china so it is feasible to hire as many sales people as needed. As long as the cost can be covered by sales growth, it is worth to do so because market share increases. Domestic manufacturers assume promotion and sales functions from the very beginning. But domestic manufacturers ignore their core function is to provide good products. This accounts for the loss after their temporary success.

- From the National Distributor Model to Provincial Distributor Model and eventually to Fulfillment Distributor Model, manufacturers have been shifting functions performed by distributors to themselves as they can perform these functions more efficiently.
- Function analysis helps us to predict that national distributors are not going to be eliminated if they can innovate in re-dividing functions between themselves and upstream and downstream partners and try to use their strengths to perform assigned functions most efficiently.
- What makes chain retailers stand out are wide assortment, credibility and after-sale service. This explains why chain retailers became more and more popular.
- Operators start to undertake functions of mobile phone sales.
- Different manufacturers have different preference with regard to dividing functions in the channel. The fundamental principle is that core functions should not be ignored.

6.1.3 Conflicts

Domain clashes widely exist in mobile phone marketing channels. First, as a manufacturer usually works with several national distributors, there is intra-channel conflict between national distributors of the same manufacturer. The reason why manufacturer selected more than one manufacturer was because China is huge. Different national distributors had strength in different parts of China. A combination of them could make their network coverage complements each other. However,

overlap did exist. Manufacturers thus differentiate the models or the colors of the same model sold to national distributors. This is an attempt to reduce this type of conflict but was not an optimal solution. For one thing, this requires manufacturer to have a wide range of product lines contain many bestseller models at the same time. Some manufacturer does not have this R&D capability. For another, conflict is not always bad. Certain degree of competition is desirable to enhance channel partner's performance. It could be a better solution to let national distributors take sole responsibility in the geographical regions that they had most strength, and let them compete in areas that both are not strong. The second type of intra-channel conflict comes from the fact that a national distributor usually works for a few manufacturers. A national distributor may prioritize sales effort for each manufacturer based on profit and the manufacturer's influence on the distributor. As the case of TCL shows, national distributors did not give enough attention to the late starter. This forced domestic manufacturers to embark on different channels.

Another kind of domain clash is multiple channels. This conflict is between local stores and chain retailers of the same manufacturer. As home appliance chain retailers are powerful, when it enters a new city, sometimes the local stores usually form a coalition to fight against home appliance chains and request more support from manufacturers in terms of marketing and price. If the manufacturer refuses to do so, local stores would threaten to stop selling the manufacturer's phones. The threat would not last long if the manufacturer's products are popular because it also hurts the local retailers' sales. To keep a balance between different retailers, a solution is differentiation. Supplier can offer different support, service and product to different channel types in order to help them differentiate themselves. In general, supplier will gain more cooperation from multiple channels in terms of pricing, stocking, and display if they can supply what the buyer considers to be differentiated product lines to different groups of retailers. (Coughlan et.al. 2001)

Gray market is the third type of domain clash. Generally gray market is thought to be bad by the channels members. For manufacturers, gray trade impairs their ability to charge different prices in various markets. In addition, if service levels provided by gray market retailers are lower than those of authorized dealers, brand equity may suffer. For authorized distributors and retailers, gray market erodes potential volume and may place severe pressure on after-sales service functions. However, some manufacturers not only do little to stop gray markets but are actually positively disposed toward them. Samsung is a typical example of this. Gray trade increases its market coverage as Samsung uses national distributors whose networks do not cover fully the volume market. A large portion of Samsung's market share comes from grey trade. Further, gray market puts pressure on authorized channels to compete harder and makes the product available to a price-sensitive segment, while maintaining a highbrow image.

Domain conflict often leads to a new channel strategy and a new equilibrium in which

different channel forms come to coexist and to do business in new ways. This adjustment comes about when all parties can be made to realize that the environment has changed and that markets have split into new segments, each demanding a different level of service outputs.

Besides aforementioned horizontal conflicts, vertical conflicts can be observed in vertical integration and dis-intermediation. Some chain retailers like Zhongyu started backward integration into phone manufacturing, while some manufacturers integrated forward to open direct ships. I see no strong justification for such integrations. For Zhongyu, it probably treated mobile phones as FMCG that supermarkets introduced private labels as low-price alternative. But the mobile phone market was very crowded. Existing manufacturers already launched low-price models. Besides, mobile phones are not like grocery. Consumers still care about brands. These might account for why Zhongyu's private label phones do not pull off a great coup. As to manufacturer forward integration, there is no specific know-how and customized physical facility required on intermediaries. What the manufacturers want to achieve is control. But control has no meaning in itself if it does not bring profit. Dis-intermediation made national distributor forward integrate into retail or strengthen provincial branches to compete with provincial distributors.

In some ways, channel conflict over direct selling has been a positive force. Direct selling has obliged all parties to reexamine the patterns and habits they have adopted over time with the result that all parties are refining their roles. (Coughlan et.al. 2001) For instance, due to threat of dis-intermediation, national distributors started to transform themselves to compete more efficiently. A certain amount of conflict is even desirable. An example is that TCL keeps at least two provincial distributors in one province to keep a desirable degree of horizontal domain clashes.

- Horizontal conflicts i.e. domain clashes widely exist in mobile phone marketing channels. The first type is intra-channel conflict; the second type is multiple channels; the third type is gray market.
- To solve intra-channel conflict between national distributors of the same manufacturer, the solution from the manufacturer is differentiation. To solve intra-channel conflict that a national distributor usually works for a few manufacturers, the solution for the manufacturer is to find new channels.
- To keep a balance for multiple channels, a solution is differentiation.
- Gray market brings both positive and negative effects to manufacturers.
- Domain conflict often leads to a new channel strategy and a new equilibrium in which different channel forms come to coexist and to do business in new ways.
- Vertical conflicts can be observed in vertical integration and dis-intermediation. Most vertical integrations in the industry do not have good justifications. Dis-intermediation made national distributor forward integrate into retail or strengthen provincial branches to compete with provincial distributors.
- Conflicts also have positive effect on channel member performance.

6.1.4 Networks

The internationalization theory from a network perspective explains foreign manufacturers' channel strategy in China well. The three first movers had little knowledge about Chinese mobile phone distribution when they entered China. Before China's entry to WTO, foreign manufacturers were not allowed to establish distribution companies in China. There were many restrictions even in setting up regional offices. National distributor offered a feasible and simplified solution. As network theory explains a company's internationalization process, this is minimization of the need for knowledge development, minimization of the demands for adjustments, utilization of the positions in the market occupied by established firms. Foreign manufacturers hence utilized the market investments that the national distributors had made earlier, thereby reducing the need for its own investment and risk taking. As the volume sold increased, the increase in the market assets might justify further investment. In this way, some resource adjustments can be made possible by giving up control over the operations in exchange for the flexibility needed to reduce risk taking. Other foreign manufacturer followed the same path when entering Chinese market.

The reason why domestic manufacturers could go for provincial distributors or direct supply to retail shops from the very beginning was due to their established network positions. A manufacturer's relationship within a certain network gives itself access to related networks. Bird was in pager business and had access to a nationwide network of telecom retail stores. TCL and many other domestic manufacturers were home appliances manufacturers. They could make use of national sales force and relationship with home appliances distributors and retailers. The same reasoning applies to ZTE and Huawei. Both are mobile system providers. Their network position constitutes relationships with operators and other stakeholders. It is not hard for them to establish mobile phone distribution channels through indirect relationships with members in the industry network.

The number of suitable retailers, distributors, users and suppliers in any network is limited and this will restrict any company's ability to change its network of relationships, or for newcomers to develop the relationship they might want. (Coughlan et.al. 2001) Before going for provincial distributors, Nokia went to Motorola's 4 regional distributors to seek cooperation, but got a NO answer. The interdependencies in networks make change problematic. Motorola and its regional distributors developed their relationship over time which involves the individuals worked at both companies, the resources that complement each other and the adaptation of operational aspects. This requires investment in time and money. Either is reluctant to give up all previous efforts.

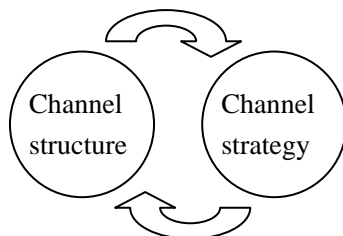
In the short term, stability will enhance distribution performance and an absence of change should not necessarily be taken as a sign of inefficiency. The distribution

infrastructure and the relationships require substantial investments and so the costs of changing them are very great. In turn, this means that change is unlikely to be attempted unless the potential benefits are considerable. However, in the longer term, the search for efficiency in distribution networks will lead to changes. (Ford 2003) So we can see within first and second stage, there is a certain degree of stability in terms of dominant distribution structure. But viewed from a longer time span, the distribution structure changes drastically.

The potential for adaptations and changes will be seen differently by the companies in the network. Some companies might identify them as opportunities while other might consider them as threats to their existing position and to the stability on which it is based. (Ford 2003) For example, national distributors took manufacturers' switch to provincial distributors and chain retailers as threats. Radical changes in distribution often originate from companies outside a structured network. These innovators have made no investments in the prevailing structure and order, nor do they feel obliged to stick to the established rules of the game. (Ford 2003) This is the reason why domestic manufacturers had more freedom in changing channel structure than foreign incumbents did.

- When entering Chinese market, foreign manufacturers utilized the market investments that the national distributors had made earlier, thereby reducing the need for its own investment and risk taking.
- The reason why domestic manufacturers could go for provincial distributors or direct supply to retail shops from the very beginning was due to their established network positions.
- In the short term, companies tend to be locked into the network position it is placed due to interdependencies. This leads to short-term stability which enhances distribution performance. In the longer term, the search for efficiency in distribution networks will lead to changes.
- With regard to adaptations and changes in network, some companies might identify them as opportunities while other might consider them as threats to their existing position and to the stability on which it is based.

6.1.5 Interaction between Channel Structure and Channel Strategy



As discussed earlier, channel structure tends to be stable in short run. At a certain point of time, the channel structure is taken as given. Researches on channel strategy

usually assume a very high freedom that companies enjoyed to deploy their channel strategy and attempt to work out an ideal model of strategy formulation. However, the reality is far from that. Most of the time companies are left with very limited choices. Channel strategy is made out of the channel structure of the time. For example, when Nokia entered China, the only feasible choice was to use national distributors. This makes firms tend to think about short run rather than long run. However, it is very beneficial for firms to think in longer term. As Coughlan et.al. (2001) points out, *“the problem with many manufacturers is that they merely react to opportunities or to problems, one by one, as they arise and try to create an appealing post hoc rationale. The eventual outcome is an ill-assorted collection of distribution choices made at different times by different managers facing different pressures. The marketing channel that emerge is incoherent and functions far below what the manufacturer should expect from its channel. Unfortunately, past choices tend to lock it into these regrettable channels”*.

Manufacturer channel strategies have direct and indirect effects upon channel structure. Each manufacturer’s channel strategy played a small part in determining the overall channel structure. Nokia and TCL’s similar channel evolvement from many levels to a few levels are generally in consistency with and are subsets of overall channel structure. The National Distributor Model was formed due to the channel decision of many manufacturers at that time, so did the Provincial Distributor Model. Manufacturer channel strategy indirectly shapes overall channel structure through corresponding reactions taken by competitors. Domestic manufacturers using provincial distributors consequently caused foreign manufacturers to follow suit. Manufacturer channel strategy also indirectly shapes overall channel structure by influencing channel partners. For instance, national distributors started to change because foreign manufacturers abandoned some of them.

In the long run, channel structure is not stable. It is because the afore-mentioned effects take place, causing channel structure to change. As a result, old channel strategy is not suitable any more. New channels strategies are needed. New channel strategies will have new direct and indirect effects on channels structure and cause it to change in the long run.

- Channel strategy is made out of the channel structure of the time.
- Manufacturer channel strategies have direct and indirect effects upon channel structure, causing channel structure to change in the long run.
- Changes of channel structure lead to new channel strategies.

6.2 What could the future mobile phone channel structure look like?

First, as I mentioned in research question 1, the current number of mobile phone

manufacturers is not reasonable. Surplus means a big waste of resources in society. Soon after loosening license system, Ministry of Information Industry enacted a regulation that the license is going to be taken away if a manufacturer's inventory is extremely high. The market is going to consolidate into a few domestic and foreign players. Siemens and Alcatel have sold their mobile phone business. We will see more exits in the future.

Second, when it comes to the future structure of the rest institutions in mobile phone marketing channels, the situation is not so straight forward. Based on my analysis in research question 1, the following two scenarios are probable.

6.2.1 Scenario One

Since a company's network position is locked into its past relationships, the channel structure is not possible to change drastically in the short term. As a result, in the near future, the most likely scenario will be chain retailers dominant in 1st to 3rd tier cities while local stores supported by strong national or provincial distributors cover fragmented place in 4th tier cities and countryside. Many reasons account for this scenario. Firstly, as explained earlier, chain retailers have many advantages over local retailers and therefore have very good chance to continue their dominant position. Chain retailers are expanding into 2nd and 3rd tier cities. Their financial and marketing muscles will help them to defeat the local stores in the cities they enter. Secondly, national distributors, while lost ground to provincial distributors, may find their way out by providing good services to chain retailers. Because home appliance chain retailers are expanding, national distributors' network might provide better network coverage and synchronization. Finally, manufacturers are willing to go downstream contacting retailers as function analysis indicates. This provides better opportunity for chain retailers because of economies of scale.

However, there is ceiling to chain retailers' expansion as 4th tier cities and countryside are too small in scale for chain retailers to be profitable. Local stores will serve these areas well enough. Due to the existence of local stores, local distributors will survive to a certain degree. Furthermore, some distributors will become chain retailers or specialized service companies for example in physical distribution etc.

As to whether it is home appliances chains or professional chains which will take the lead, it is contingent on change of environment and their own strategies. Currently intermediaries seldom provide value-added service in the channel. Professional chains are in a better position to provide their expertise and after-sale service to attract consumers. On the other hand, when 3C integration does happen, home appliance chains are in a better position to integrate their different departments.

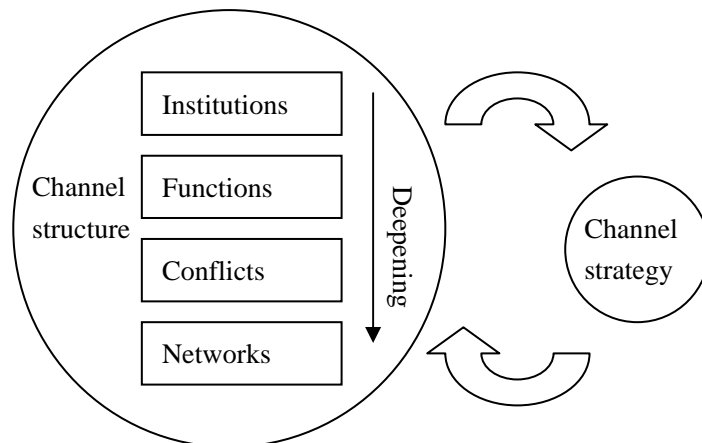
6.2.2 Scenario Two

The 2nd scenario is along a longer time horizon. As mentioned earlier, in the long run, channel structure and channel strategy interact and the overall channel structure is bound to change. Also, domain conflicts often lead to a new channel strategy and a new equilibrium in which different channel forms come to coexist and to do business in new ways. Manufacturers who see opportunities in operator distributing mobile phones will also adjust their channel strategy to benefit from it. Operators have already started engaging in mobile phone distributions and they are likely to become dominant channel and retailer channels will be complementary. Many reasons justify this. First, operators have the resources to do it. Operators have the most important resource- the subscribers. Besides, operators have strong relationships with all kinds of stakeholders-government, mobile phone manufacturers, mobile system providers, national distributors and chain retailers. It is feasible for operators to take the role of central hub in the network of relationships. Second, from social resource allocation perspective, it is more efficient for operator to do it. No redundant channel construction is needed. All the manufacturers share the same channel. Manufacturers save a lot of marketing expenses. Third, operators need to provide more value-added services to subscribers. When 3G comes, it is more important for operator to have control in retail end to know what consumers really like. Fourth, it is probable that two more operators will enter the market. In that case competition is going to increase, causing operators to play a bigger role in distribution channels.

Technological advancement is more than what human being could imagine. It is likely that mobile phone is no longer a phone in the future. It is a multimedia terminal, a mixture of 3C. Even further it will not be sold in the way of hardware any more. What consumers want is utility, not hardware. What a consumer buys could be a package of services with music, gaming and email etc. This refers to Levitt's famous article "Marketing Myopia"- don't confine your thought in your own business or in the old way of doing business; look around in substitute and related industries. Selling hardware is a one-time deal, while selling service is continuous. Hardware manufacturer like IBM is shifting from hardware to service. If the same thought applies to mobile phones, operators will act as a hub connecting manufacturers, distributors and content providers. Operator outlets will be some kind of experience centers where consumers can try the value-added services. Under this situation, it is not so much about technical aspects such as 3G or 3C which is already available, but about content. A kind of channel member specializing in content will emerge. A new value constellation rather than value chain needs be created in which each member performs part of the job. It is a key issue about how to divide the job and how to work together efficiently. It also depends on consumer's acceptance of the services provided. National distributor could also be part of value chain if they could come up with innovative way of assuming functions. As shown in Dopod's way of working with China Mobile, national distributor took the role of physical distribution, resorting to their sound distribution network.

Some manufacturers like Motorola and Dopod have foreseen the operator's future dominance and are working in the direction. Operator channel will offer excellent opportunities for mobile system provider like ZTE and Huawei to become powerful players in a new round of competition.

7. Conclusions



The paper sets out to answer two research questions:

1. What is the evolvement of mobile phone channel structure in China?
2. What could the future mobile phone channel structure look like?

For Question One, the evolvement of mobile phone channel structure is analyzed from four dimensions. In terms of institutions, the number of manufacturers has been increasing dramatically during the past 10 years. These manufacturers are of various types and therefore have different strengths and weaknesses. In future we shall see a consolidation among these manufacturers. Distributors have gone through a process of national distributor dominant to provincial distributor dominant. As to retailers, it has been from local stores in big telecommunication market dominant to chain retailers dominant. Operators are increasing their influence in channels recently. When it comes to functions, we see a trend of manufacturers internalizing more and more marketing channel functions. With regard to conflicts, domain clashes are the biggest horizontal conflicts and dis-intermediation is the biggest vertical conflict. When we look at channel structure from network perspective, the way how manufacturers established distribution channel is determined by their own resources and resource ties with others. In the short run the distribution channel network tends to be stable as firms' network positions limit their freedom to change. However, in the long run, the distribution channel could take a very different look as relationships change over time. This change to a certain degree result from mutual interactions between channel structure and manufacturer channel strategies.

For Question Two, it is predicted that two types of channel members will rise as

dominant players in the future. In the short run, chain retailers will take the lead due to their large scale and strong financial and marketing resources. Local stores and distributors will survive in fragmented areas complementarily. In the long run, however, operators have the largest possibility to stand out. Operators have both the resources and the incentives to take over retail business. With development in 3G and 4C, a new value constellation needs to be formed. Operator will be the central hub connecting manufacturers, distributors, retailers and content providers. Operator outlets could take the form of experience centers.

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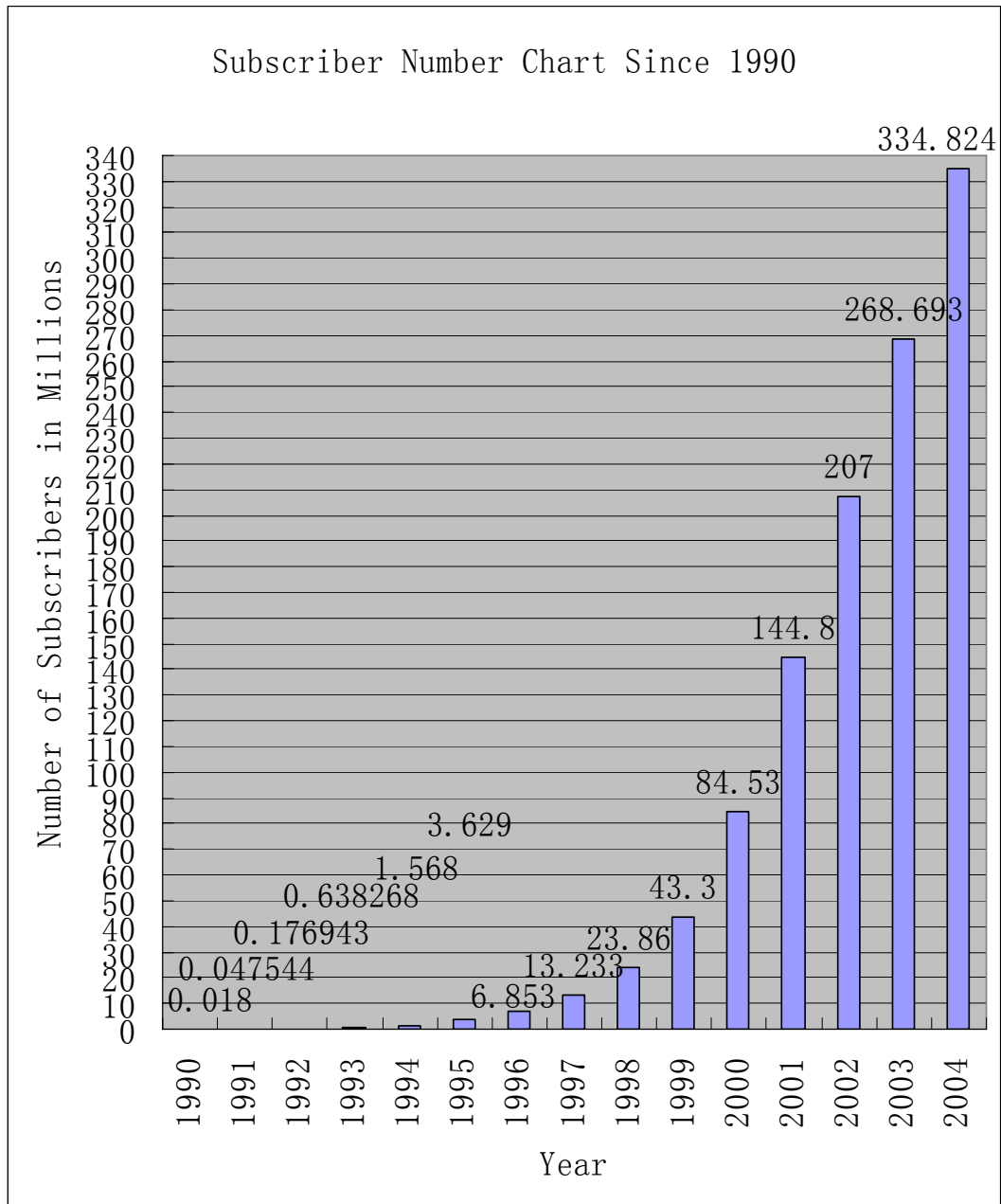
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9. Appendix



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