

# Analysis on China's Major Retailers Profit Model: Theory Review and Prospects

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**Abstract:** In recent years, with the formation of a buyer's market and the change of retail-supplier relationship, especially the expansion of large retailers scale and vertical control capabilities, many domestic large retailers's profit model and profit structure has undergone fundamental changes. A variety of Slotting Allowances and rent become major source of profit, also known as the "rentier-type" profit model. However, this profit model is pregnant with all kinds of crises, and to be harmful to the sustainable development of the supply chain. For this reason, an urgent need to strengthen study on the profit model of large retailers. In this paper, through literature review, we explore the nature and content of the retailer profit model and analysis the advantages and disadvantages and the future development direction of existing major profit model, hope to with provide some inspiration to strengthen the retail profit model studies.

**Keywords:** profit model; large retailer; theoretical review; research prospect

## I. Retailers Profit Model Definition and Classification

On the profit model, scholars have given different definitions. One view is that it is the business and stakeholders through their own resources to form an integrated value creation, value distribution of access and benefit-organizational mechanisms and business structure . Another view was that it is exploring sources of business profits, generate way the system processes and output method. The former model will be profitable as a commercial structure, which will be considered as a profitable way. In fact, there are no essential difference between the above view, the core is stressed: profit model is the composition of corporate profits, methods and potential.

Less scholar definite the retailers profit model individually, the general definition of profit model is expanded to "retail". Such as Tang na, WANG Xianqing (2006) think that retail profit model is the retail business use it's own characteristics and advantages to take appropriate measures in the format choice, size selection, mode of operations and optimizing the industrial chain to get a profitable management mechanism. Wu Xianhe(2006) think that the flow of circulation industry profit model is the ways and means to make profits, but also the sum of enterprise resources and operational structure.

On the classification of retailers profit model, scholars have different opinions, and has no unified classification of views.

There are two major categories, one is from a theoretical point of view and summarized, such as Li Jun Yang (2006), the retailer profit mode has divided to "gross profit" and "backstage profit", the former is net price of goods model, the latter is channel charge model. WANG Xian-qing (2006) listed the retail profit model into four classes: Yetai expansion type, scale and efficiency, optimization of business and industry extending. WANG Xu-hui (2008) hold that there are four current retailers profit model: to rely on profits buying and selling spreads, profits depend on type of financial model, slotting allowance to rely on profit and low cost by optimizing the supply chain profit model. Lang (2006) compared Chinese and foreign retail enterprises profit models, think the retailers profit model is divided into "value chain profit model" and "non-value chain profit model", but he did not give a clear definition. Chen Liping (2009) think retail profit model will be divided into "rentier type" and the "value type" and that "rentier type" Retail profitability depend largely on access fees charged, as to avoid market liquidity risk, also known as " maintain profit type", and "value type" refers to the circulation through the retail value of innovation to create profit for profit model. Another extract from a practical point of view and concluded that the retailers profit model mainly net price model, the channel charge model, own-brand models, online retail model, type of financial mode. In this paper, from a practical point of view according to the classification of the existing retailers theoretical profit model synthesis and analysis and evaluation.

## II. Retailers profit model of the current analysis and evaluation

### Net price model

A Net price model means the retailers purchase from suppliers through the cheap and then sold to customers at higher prices, buying low and selling high, making the spread in the profit model. Retailers main source of profits is by expanding the sales network and increasing the size and force suppliers to lower the purchase price, while the use of advanced management experiences and technologies to reduce costs and expenses, obtain the purchase price and the retail price spreads in order to achieve profitable purposes. Zhang Jinping, Li Hanling (2006) think that the commodity-based net price has two advantage: one can accelerate cash flow of suppliers to reduce the risk of sale; on the other hand, retailers can get a lower purchase price, and can accord to market conditions to determine the sales price, with some

flexibility.

Li Fei, WANG Xu-hui (2006) from the market environment, customer value, profit from the three dimensional analysis shows that: from the founding to 1989, China's supply of goods in short supply, customer value simply reflected to buy what want to buy According to the government provides, but the quality of goods, personnel services, shop location, communicate and store information are not easy to get, leading to a simple profit model of net price profit model under the state control, the spread comes from retailer's sales and for production functions(storage and transport) for the manufacturers to get the profit distribution. At that time, the national 29 key department store's net profit margin at 7%, of about 28 retail stores focused on food net profit margin is 4% -5%, and the industry average net profit margin is about 3%.

Today, China's retail market has undergone tremendous changes, under the conditions of shortage economy has been fully converted to a buyer's market, customer value to buy goods from a simple inexpensive upgrade to the needs of good commodity. Retail profits comes from both the buyer-driven decisions and the control system of the market. At the same time, our retail business as too small to get scale advantages and costs reduce; and low levels of business management modernization, the limited capacity of enterprises to control costs, resulting in difficult to gain profit under this profit. In addition, the net price of this profit model calls for adequate procurement funds, and market price movements have a more accurate predictive capability, or may result in product backlog, increasing the cost of funds used (Zhang Jinping, Li Hanling, 2006). Therefore, it is need to through a strategic alliance to enterprises bigger and stronger, through the use of advanced science and technology to reduce costs in order to seek survival and development in the competition.

Wal-Mart is the typical representative of "net price" model. In fact, the fundamental profitability of the net price approach is to implement low-cost strategy. Its slogan is "Always low prices", obtained through large-scale procurement and sales of high margin, low-cost expansion is the main source of its profits. Wal-Mart in the early days and always focus on the development of cost control, and the first to build an advanced information management and logistics and distribution system, which makes Wal-Mart's sales costs are lower than the industry average cost of 2% - 3%, attain the success of the Wal-Mart retail empire, long-term competitive advantage.

From the nature point of view, the basic function of commercial is the exchange tool, spatial and temporal regulation, force balance and the achieving interests (Xu congcai, 2006), net price model is the most traditional profit model which the business take its basic functions while achieving value creation of the basic means of the retail business, with some rationality. At present, with the intensified market competition and a major shift in production and marketing relations, net price model margins

are more restricted, according to statistics, currently the major supermarket industry average net profit was only about 1%, therefore, urgent need for innovation and profit model, out of pure net price model, high-end value chain from retail to obtain new competitive advantages.

### Slotting Allowances model

Slotting Allowances is the supplier to make their products into the retail business sales area and display shelf, one-time payment in advance to the retail business, or sales at a later payment of the fees charged by the retailers. Slotting Allowances charged by retailers, a wider, including the sponsorship of opening new stores, Dianqing sponsorship, media advertising, floor display advertising, newsletter sponsorship, festivals fees, unconditional rebates, discount store opened, loss compensation etc<sup>[1]</sup>. foreign scholars's view on Slotting Allowances profit model are controversial, mainly have two schools: schools of markets and schools of efficiency.

Efficiency schools hold that by charge slotting allowances can improve the efficiency of the industrial chain, with product quality signal display, manufacturers and retailers to promote realization of effective cost sharing and risk sharing, thereby enhancing the efficiency of new product sales, shelf space for a reasonable distribution, regulating demand and supply, reducing the role of the retail price. Foreign scholars holding this view are mainly Chu (1992), Larviere (1997), Lariviere and Padmanabhan (1997), Kelly (1991), Sullivan (1997), Toto (1990), Sackuvich (1998) and so on.

By MacAvoy (1997), Sullivan (1997), Marx and Shaffer (2007), Kuksov and Pazgal (2007) to represent market power school of thought is that the access fees charged will increase power and reduce competition in retail markets. The main points are: access fee is charged for retailers to exercise its channel structure in the market a manifestation of market power, which undermines the channel relationship; leads the market in the retail sales price discrimination, a discrimination means; damage manufacturing fair competition among providers is a strategic tool to restrict competition; slotting allowances also destroyed the competition in the sale order; is a source of channel conflict; easy cause retailer in higher prices, the welfare loss in consumer .

Domestic research scholars analysis the causes and effects of slotting allowances from various perspective, think that charge slotting allowances can enable retailers to choose the stronger suppliers, has a certain rationality. Ma Longlong (2004) study pointed out that commercial shrinking profit margins and consumer dynamic profit center to promote the business upward<sup>[2]</sup>. Vendors are facing an unprecedented era of shrinking profit margins of commercial test, the pressure will inevitably profit transfer to the upstream supply chain, so to a " slotting allowances " . Wang Hao (2006) using a dual oligopoly model of the supermarket channel charges on the market impact of the parties involved. He noted that access charges are a large chain retail

enterprises capitalized means of its market power. This strategy has strengthened the major supermarket chains in the price advantage, on the other hand weak market forces driving up the purchase price of other supermarkets. Shi Qi, Yue Zhonggang (2008) study suggests that retailers display trading functionality and market creation capabilities; retailers with cross-network externality; retailers and consumers change the interactions between the three aspects of the retailer to obtain ability of vertical restraints, the reasons for charging access fees. Yue Zhonggang, Zhao bo (2008) study shows that access charges are important mechanism for large retailers, manufacturers and consumers to balance the interests of the internalization of externalities, has a certain rationality.

Some scholars have questioned. Such as Li Jun Yang (2007) that slotting allowances arise because the profit model market power imbalances and irregularities retailers, the retail industry, "Matthew Effect" to promote the formation of large-scale retail enterprises to benefit from the supplier upon the impulse. And that the retailer charged with tax evasion in the nature of the slotting allowances. Li Fei, WANG Xu-hui (2006) that with the introduction of government policies on the purchase of retail enterprises, channel costs and payment terms will be limited, retail, outside the main business income will be reduced. Same time, this part of the revenue should be used to provide promotional services for the company expenses, but not all directly into corporate profits<sup>[3]</sup>. WANG Xu-hui (2008) that the slotting allowance model for the relationship is not conducive to the harmonious development of retailer-supplier relationship, implies a boycott suppliers, capital strand breaks of potential crisis, which are lack of sustainability. Shen Shao-Qiang (2009) that department stores in Xiamen, ZhongshanLaiYa-collapse case analysis shows that: slotting allowances profit model at higher risk. That precisely because " slotting allowances " model has led to the unreasonable nature of the blind expansion of the retail business, investment and risk increase, which causes defeat.

In short, the slotting allowances model is a controversial model, retailers can use their initiative in circulation to the suppliers to a wide range of costs, sharing the profits of suppliers, it could lead to conflict in suppliers and retailers. The more typical case is the 2003 Shanghai roasted industry associations and Carrefour (China) open conflict called "roasted storm".

At present, China's retail industry as a short time a large number of investors to enter a highly competitive situation, coupled with international commercial capital to invest in the development of China as a major country, exacerbated by growing competition, leading to low-margin retail business by the formation of gross profit, we can not guarantee profitable after the amortization of costs. Therefore, in the general merchandise business profit model can not be formed, at this stage of the profit model based on slotting allowances has formed (Zhu Rong po, Zhang Jie,

2006). However, the slotting allowances profit model also increased the cost of such contradictions in business relations is not conducive to a lasting competitive power of China's retail industry and sustainable development with economic development and improve the law, our retail slotting allowances charged will shift to more healthier profit model.

### Private brand model

Private brand model refers to the profit model which the retailer through the sale of their company's sign or mark of the same product to get sales profits. Scholars generally believe that own-brand retailers to expand in the future profitability of channels to enhance profitability in one direction, and discuss its advantages. Reda (2002), Corsjens & Lal (2000) that retailers help retailers differentiate their private brand suppliers to attract consumers by increasing the potential profit, there private brand help retailers to control costs and build brand loyalty retailers. Mills (1995) of a national brand and retailer own-brand product sales interaction, found that retail sales of private brand products sales if a certain quantities will allow consumers to buy lower price to the corresponding products, which will enhance the vertical structure of industry performance. Wilcox & Narasimhan (1998) proposed the use of retailers private brand as a national brand from a manufacturer better trading conditions of the strategic means.

Some scholars have pointed out that the retailer's private brand strategy will also give manufacturers the corresponding benefits, is the best selection and meet both the advantages of retailer and supplier. Hoeh & Banerji (1993) that manufacturers can use excess capacity of production of own-brand retailers, more efficient use of manufacturing and distribution facilities to achieve economies of scale; the same time, production of private brands and retailers can improve the relationship between the benefit common run their own manufacturer brands. Fu Guo-qun (2001) that both the premium type of product retailer brand supplier profit opportunities, but also help to promote product innovation. Zhu Rong po, Zhang Jie (2006) find that low-cost own-brand products, it can give the retail business market management initiative and the initiative in setting prices is beneficial to form strategic business alliances.

Hoch and Banerji (1993), Kevin Lane Keller (1998), McGoldrick (2002) point that retailers also made its own path and method of implementation of the brand. Kevin Lane Keller (1998) that the brand's competitive advantage lies in its own low prices, low price strategy was advocated. In reality, the retail market, private label prices are usually lower than manufacturer brands 20% ~ 40% (McGoldrick, 2002). Hoch and Banerji (1993) have also repeatedly stressed that retailers provide "high quality - relatively low price" products will be the most correct choice. In contrast, Verhoef, Nijssen & Sloot (2002) think that only low-cost strategy is not feasible. Pointed out that the traditional

symbol of its private brand is cheap, but now the core competitiveness of its private brand has been transferred from low-cost to high-quality, retailers can provide to meet the high-class consumer products, development of high-priced, brand directly with the community competition. Clark (1981) that the most successful private brand compared to those with existing brands have obvious "advantages" of the brand. MeGoldriek (2002) also suggests that if a private brand and other brands only the price difference, it will soon disappear. Zhu Ruiting (2004) that the retailer's private brand to have accurate market positioning, the product range is generally required for daily living households, consumption of large, fast turnover of goods. A product is a combination of factors reflect, including the performance, structure, composition, packaging, shape, quality, price, market positioning of retailers private brand is to strengthen or enlarge certain product elements to form different unique image.

At present, the most successful branded retailers is a Swedish IKEA furniture, all of its sales come from its private brand. Almost slightly larger in foreign retail enterprises have their private brand. U.S. retailer Sears famous brand products 90% are from private brand products, Japan's largest retailers, Daiei chain accounts for 40% of the number of its private brand. Britain Marsh (Marks & Spencer) is the UK's largest department store group of transnational retail groups in the world more than 260 stores across all of its own-brand goods are used "St. Michael" brand, known as the world the largest "no factory manufacturer," while Marsh the highest profitability of the Group is the UK retail group, the profitability of sales per square foot basis, the London store of Marsh Group have more profit than any retail store in the world (Liu Kunshan, 2004).

In our retail business in its private brand of merchandise, and most retailers do not have the ability to expand its private brand and inertia under the corrosion of the profit model of adopting slotting allowances, collection of rent or class of financial profit mode. Even if there private brand is also generally are low-value products and low market share. Such as Shanghai Lianhua, though they have their private brand, but the own-brand products are few. Beijing Hualian, Nanjing Suguo have a small amount of washing daily food supplies and its private brand. In the future, China's retail enterprises needs to develop its private brand actively, so that their brand can be the source of profits of enterprises, enhance endogenous profitability and build its private brand profitable.

#### **Online retail model**

Online retail is the two sides of deal use the Internet as a medium of commodity trading activities, conducted through the Internet, the organization and delivery of information to achieve the tangible goods and intangible transfer of ownership of the goods or services to the consumer. As a profit model, online retail model can be simply defined as

the retail use of Internet technologies to optimize the value chain, which sells its goods to a customer. Generally refers to the domestic trade in B2C e-commerce model that can break the traditional retail space and time constraints, real-time economy, enhance customer value.

On the advantage of profit model in the online retail profit compared to the traditional model. Zhang Qingliang, He Wenjun (2000) believes that online retailers have advantages and characteristics such as shopping time at random, spatial virtualization, Fast information processing technology, low operating costs, open information resources. Sha Zhenquan, Wang Jing (2004) found that online retail comprehensive consumer information, shopping convenience, providing expertise, anti-jamming, fast and transparent customer value, etc., is an important factor in its success. Pang Ailing (2008) that online retail is: no space restrictions, all-weather operating advantage; relatively low operating cost advantages; no inventory of products in traditional retail to improve the situation of poor sales; close customer relationship to a deeper understanding of the user; meet Consumers seeking fresh, modern, psychological advantage ahead of consumption.

Zhang Qingliang, He Wenjun (2000), Liu Yun (2002), Zhu Rong po, Zhang Jie (2006) piont out the current problems of the online retail sales in our country. Zhang Qingliang, He Wenjun (2000) that the current constraints in China now have online retail network and inadequate infrastructure, security issues, credit issues, legal issues, means of payment problems, logistics and other six issues. Liu Yun (2002) that, in addition to these factors, consumer acceptance issues, some commodities are not suitable for online sales and other issues are also factors that restrict online retail. Zhu Rong po, Zhang Jie (2006) think that our retail and online retail business few profitable because logistics and distribution system is not sound and e-commerce security bottlenecks, lack of enterprise information technology, concepts and other restrictions<sup>[4]</sup>.

On the implementation of strategies of online retail profit model. Cheng Hua (2002) study suggests that consumer acceptance of online retail model is a gradual process, it should be changed to minimize the extent of consumer acceptance of innovation, design innovation and progressive change in shopping patterns, to facilitate consumer acceptance of online retail innovation model and the promotion of Online retail development. Xiao Yu (2003) discussed the online retailer's product strategy. That should be taken into account the constraints in the development of electronic commerce, Internet users characteristics and buying motives, according to the different product categories, identifying the types of products for online sales. Zhao Weihong (2007) that the network of retailers, customers trust in the formation of customer loyalty has a central role. Internet retailers must fully understand and grasp the online customer loyalty laws of psychological development, the implementation of effective, differentiated customer loyalty strategies. Yang Xingchang (2009) suggests that shopping

security and privacy protection, site of the interactivity, product price advantage online retailing service quality affect are three most important factors. This is the online retail development needs to enhance several aspects of attention.

Pang Ailing (2008) argue that the traditional retailers, online retailers face alternative development model are: First, extension of time and space advantages of the traditional retail business and can be unique, and second, the transfer for the online retail forms that replace the traditional retail and online retail, third is the traditional achieve integration of retail and online retail mall + . com form.

In reality, most retailers choose the traditional retail and online retail integration of development models, such as Wal-Mart and America Online, Yahoo's co-operation, based on its well-known brands and strong financial strength and perfect logistics system to actively expand sales . Beijing Xidan Market igo5 Online Shopping Mall opened in 2002, is the first platform in the large state-owned commercial enterprises based on the construction of integrated, advanced Internet business enterprises, and supporting physical store of traditional profit model to the traditional retail + online retail profit model.

It can be said that our retailers from the traditional profit model to change the direction of online retail has become an inevitable trend of history. Ministry of Commerce (Commerce [2009] No. 540) also issued a document to promote the flow of business e-commerce. That the flow of e-commerce enterprises to expand both online consumer groups, cultivate new consumption patterns and consumption and help to reduce the flow of costs and speed up the value of goods and services, ultimately. Therefore, promote circulation of e-business development is to address the financial crisis in our country, and expand people consumption, to maintain an effective means of economic growth momentum, is to improve Efficiency of Commodity Circulation, change the inevitable requirement of economic development mode.

### **Type of financial model**

Type of financial model mainly refers to the retailers by extending the account of, access fees charged way, possession of suppliers for various investment activities themselves (such as real estate and stock market), the profit model for quick profits. This profit model is characterized by rolling type and scale of expansion, the retailer to extend the account by means of possession of money after the vendors, to invest in the development, after the repayment of loan maturity, and then hold the next batch of money, so again , sleight of hand tricks; In addition, the larger retailers, their possession of money and financing capacity is, to further stimulate take up more funds to expand the scale of the desire to promote the development of financial models of its class. Sheng Jingyi (2009) on the case analysis also showed that Gome: Scale operation did not increase the size of business and profitability of its core business, but to

improve the income of non-core business to create the conditions for strengthening the capacity of deferred payment loans to improve channel supplier costs.

Most scholars criticize to the financial model. Lang (2004) analysis of that type of financial profit model has its own inherent defects, industrial and financial presence of complementarity blind, easily lead to structural differences, experience changes in the external financial environment, the catalyst will cause conflicts, which causes defeat. Yan Xin (2007) that the type of financial profit model there are still many problems to be solved, such as unreasonable structure of corporate debt, financial chain risks, tensions between enterprise and suppliers, the growth mode of a single enterprise, the enterprise's business management is low. He xun (2007) that GOME type of financial profit model is a dead loop, because the country U.S. type of financial profit model will be out of weak strength of the supplier, while the surviving enterprise voice enhanced GOME-supplier conflict of interest increased, occupancy suppliers of funds will become increasingly difficult. In short, that simply squeezing suppliers and supplier payment as a business cash flow profit model unsustainable. Cai Lin, Yan Weijie (2009) by GOME class analysis shows that financial profit model: type of financial profit model weakens the industry's profitability, resulting in the growth of Gome profit decreased gradually each year, each year from 2005 to 2007, compared with the previous year Net profit was 4.33%, 3.81% and 2.75%, sales per square meter also been declining. Meanwhile, the accelerating deterioration of the living environment of manufacturers, so that the benefits of manufacturers further shrink, weakening the industry's profitability. Jia Ping Wei (2009) more bluntly said that the main reason of Huang Guangyu events is the risk of accelerating the financial crisis and insufficiency of capital in the financial model, which led to capital-chain problems.

Yan Xin (2007) analysis of the type of financial profitability of the retail business transformation response pattern that retailers need to improve the debt structure, and to establish strategic partnership with suppliers, to change the growth mode, increasing the width and depth of management, management innovation, promote the chain upgrade. WANG Xu-hui (2006) that retailers have to develop a core value of Chinese and customers to achieve inner competitiveness higher than outer competitiveness, and promote sustainable development. Cai Lin, Yan Weijie (2009) believe that financial profit model of Gome class should change their tactics training from the location, category, network, channel, service, logistics, brand, culture and other elements of composite core competitiveness of enterprises accumulated ability to improve profitability, enhance market competitiveness.

In short, the type of financial model is the retail function of the performance degradation and deterioration, once the macroeconomic conditions change, or macro-control, manager changes, legal implications, its profitability,

"perpetual motion machine" myth will be burst, do not have sustainability.

### III. Future research prospects

Not difficult to see from the above analysis, domestic scholars conducted extensive research on the characteristics of various profit models, evaluation and model judging stage of the in-depth analysis, but little empirical research on the retail profit model, and lack of research on the evolution mechanisms and laws of retailer profit model. In fact, analysis on the retailers profit model depend on research on the evolution law and the actual operation of the retailers. Accordingly, this article hold that it can be carried out in-depth study of the following three aspects.

First, deepening division of retailer profit model under the evolution of the economic mechanism. Profit model on the evolution of retailers involved in economic background, customer value, retailer-supplier relationship between technological change and other multi-dimensional mechanism analysis, accurately characterize the evolution of retail profit model.

Second, the existing empirical analysis of retail profit model. Total fee income from the channel main structure, gross margin, occupying suppliers of funds, inventory turnover, sales turnover, cost rates and other indicators of current profits to major retailers, and profit potential, summed up several types of retailers profit model and future development direction.

Third, retailers profit model and the relationship between supply chain process reengineering. Combined with the institutional background and our special industrialization, urbanization, market, information technology, cross-cutting international economic environment of China's retail and supply chain profit model transformation process reengineering, value chain to enhance the relationship and to achieve the conditions and mechanism.

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