



# **Variants of distribution channels for given company**

**Bachelor thesis**

**Thesis Supervisor**

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## **Acknowledgement**

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Hereby, I declare that I elaborated the Bachelor thesis “Analysis of distribution channels for given company” individually and that I listed all used sources in the section references.

In Brno, December 10th 2012

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## **Abstract**

Janošek, M. Analysis of distribution channels for given company. Brno, 2012.

This bachelor thesis focuses on evaluation of current and possible distribution channels for company LR Health & Beauty Systems, s. r. o. based on situational and cost-benefit analysis. Structure of the thesis is divided into two parts. First theoretical part gives a picture of company background, current economical situation and the market segment in which the company operates in. Second practical part shows analyzed distribution channels. The very end of the thesis consists of discussion about the possible distribution channels and recommendation of the most efficient distribution channel for given company at the moment.

## **Key words**

Marketing, Distribution channel, Network marketing, Direct selling, Distribution

## **Abstrakt**

Janošek, M. Analýza distribučního kanálu pro danou společnost. Brno, 2012.

Tato bakalářská práce se zabývá hodnocením existujících a možných distribučních cest pro společnost LR Health & Beauty Systems, s. r. o. na základě situační a cost-benefit analýzy. Struktura práce je rozdělena do dvou částí. První teoretická část dává obrázek o zázemí společnosti, momentální ekonomické situaci, zázemí společnosti a tržním odvětví, ve kterém společnost působí. Druhá praktická část ukazuje analyzované distribuční cesty. Samotný závěr práce se zabývá diskuzí možných distribučních kanálů a doporučením nejefektivnější distribuční cesty pro danou společnost v tuto chvíli.

## **Klíčová slova**

Marketing, Distribuční kanál, Síťový marketing, Přímý prodej, Distribuce

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# 1 Introduction

The variants of distribution channels are analyzed in this paper in order to examine the effectiveness of products distribution for company LR Health & Beauty Systems, s. r. o. LR Health & Beauty Systems GmbH is a worldwide company currently operating in 32 countries. The company was established by Helmut Spikker and Achim Hickmann in 1985 in Ahlen, West Germany. The company yearly revenue is approximately 410,000,000 EUR (10,250,000,000 CZK).

Production includes wide portfolio of self-made products such as perfume, skin care products, cosmetics, jewelery, accessories, nutritional supplements for people and animals. The perfume brand is represented by Michael Schumacher, Heidi Klum, Boris Becker, Ralf Möller, Bruce Willis and regional brands such as Karel Gott. The company employs about 1,000 employees and cooperates with 300,000 independent LR partners worldwide. Currently, the company is managed by the management of Jens Abend (Chief Executive Officer), Tilo Ploger (Chief Operating Officer), Andreas Rutsch (Chief Financial Officer) and Thomas Heursen (General Sales Director).

The LR Health & Beauty Systems GmbH is mother company to LR Health & Beauty Systems, s. r. o. established in Ostrava – Hrabůvka. The Czech subsidiary company was established in 1993 by Ing. Aleš Buksa.

In the theoretical part there are analyzed variants of distribution channels – selling the products via existing chain of shops, selling the products via e-shop, franchising, chain of shops creation. Important part is analysis current distribution channel – direct selling and network marketing.

## **2 Objective of the thesis**

The aim of the thesis is comparison and recommendation of the most efficient distribution channel for company LR Health & Beauty Systems, s. r. o. The company used retailing distribution channel for first 4 years and last 23 years uses distribution channel of direct sales and network marketing. The thesis analyses if the distribution model used is effective for the company and its customers. The thesis states positive effects and negative effects on the business in case of changing the distribution channel to external chain of shop, selling the products on the internet, franchising distribution channel and establishing own chain of shops. For all the variants of distribution channels are stated general and specific advantages and disadvantages. Very key point of view is analyse of costs and profits. The analyse is in case of changing the distribution model under the same market and same prize. The only big difference is in distribution channel and its effects. Based on the analyses finally in the conclusion recommendation is stated which distribution channel is the best for given company at this time.

### **3 Literary survey**

#### **3.1 Distribution business models**

There are 4 main business distribution models covered in this paper :

- I. Direct selling (connected to network marketing)
- II. Selling in chain of shops
- III. Selling via external existing chain of shops
- IV. Internet selling

All these distribution models have in common – “selling”. No matter what distribution channel is used it always leads to result of selling goods or services.

Very important factor for these 4 different distribution models is advertising. For different model, different advertising campaign is needed. Henry Ford said: “If I had last 5 dollars, I would spend 3 of them on advertisement.” Today the biggest influence on consumers have mass media. Milan Postler thinks about mass media that their importance has been gradually raising. Today mass media are media of a significant influence concerning information including commercial information (advertisement). Mass media are TV, radio, print and internet. The importance of internet is gradually raising however TV is still the most powerfull mass media.

(Postler, Média v reklamě, p.19, 2003)

Every customer is attracted by different distribution model and this needs to be analyzed and diferenciatiated for different companies. Every consumer goes through consumer purchase decision process. This is described by Berkowitz, Kerin, Hartley and Rudelius. Behind the visible act of making a purchase lies an important decision process that must be investigated. The stages a buyer passes through in making choices about which products and services to buy is the purchase decision process. This process has five stages: (1) problem recognition, (2) information search, (3) alternative evaluation, (4) purchase decision , (5) post-purchase behaviour.

(Berkowitz, Kerin, Hartley, Rudelius, Marketing, p.140, 1994)

### 3.1.1 Selling

“**Selling** is the art of persuading another person to do something when you do not have, or do not care to exert, the direct power to force the person to do it. Selling is persuasion.” (Russel, Beach and Buskirk, p. 4, 1988)

“Persuasion – everybody does it! If you owned a business, you would be continually trying to persuade other people to what you want them to do: lend you money, buy your goods, sell your goods, work for you properly, pay you promptly or grant you whatever governmental permissions you might seek. Persuasion is the fabric of daily business operations. It is perhaps the main implement in the entrepreneur’s toolbox.”

Moreover, you use persuasion all the time in daily living. Whether you’re on the job, at school, or at home, or even when you’re shopping, you are continually trying to get other people to do what you want them to do.

(Russel, Beach and Buskirk, p. 4, 1988)

### 3.2 Direct selling

**Direct** – Straight; without any unnecessary actions or any extension; in this case without unnecessary mediators that prolong the distribution channel.

**Selling** – “The personal or impersonal process whereby the salesperson ascertains, activates, and satisfies the needs of the buyer to the mutual, continuous benefit of both buyer and seller.” (American Marketing Association, 2012)

**Direct selling** – “1. (sales definition) A marketing approach that involves direct sales of goods and services to consumers through personal explanation and demonstrations, frequently in their home or place of work. 2. (retailing definition) The process whereby the firm responsible for production sells to the user, ultimate consumer, or retailer without intervening middlemen.” (American Marketing Association, 2012)

According to World Federation of Direct selling Associations the direct selling provides important benefits to individuals who desire an opportunity to earn an income and build a business of their own. To consumers provides direct selling joy of an alternative to shopping centers, department stores or the like. It offers an alternative to

traditional employment for those who desire a flexible income earning opportunity to supplement their household income, or whose responsibilities or circumstances do not allow for regular part-time or full time employment. In many cases, direct selling opportunities develop into a fulfilling career for those who achieve success and choose to pursue their independent direct selling business on a full time basis.

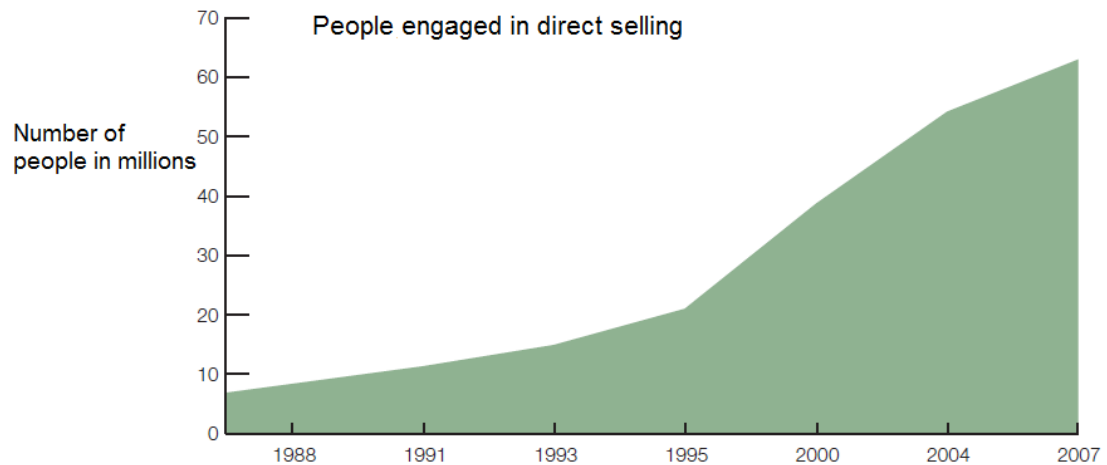
The cost for an individual to start an independent direct selling business is typically very low. Usually, a modestly priced sales kit is all that is required for one to get started, and there is little or no required inventory or other cash commitments to begin. This stands in sharp contrast to franchise and other business investment opportunities which may require substantial expenditures and expose the investor to a significant risk of loss.

Consumers benefit from direct selling because of the convenience and service it provides, including personal demonstration and explanation of products, home delivery, and generous satisfaction guarantees. Moreover, direct selling provides a channel of distribution for companies with innovative or distinctive products not readily available in traditional retail stores, or who cannot afford to compete with the enormous advertising and promotion costs associated with gaining space on retail shelves. Direct selling enhances the retail distribution infrastructure of the economy, and serves consumers with a convenient source of quality products.

An important component of the Direct Selling industry is multilevel marketing. It is also referred to as network marketing, structure marketing or multilevel direct selling, and has proven over many years to be a highly successful and effective method of compensating direct sellers for the marketing and distribution of products and services directly to consumers.

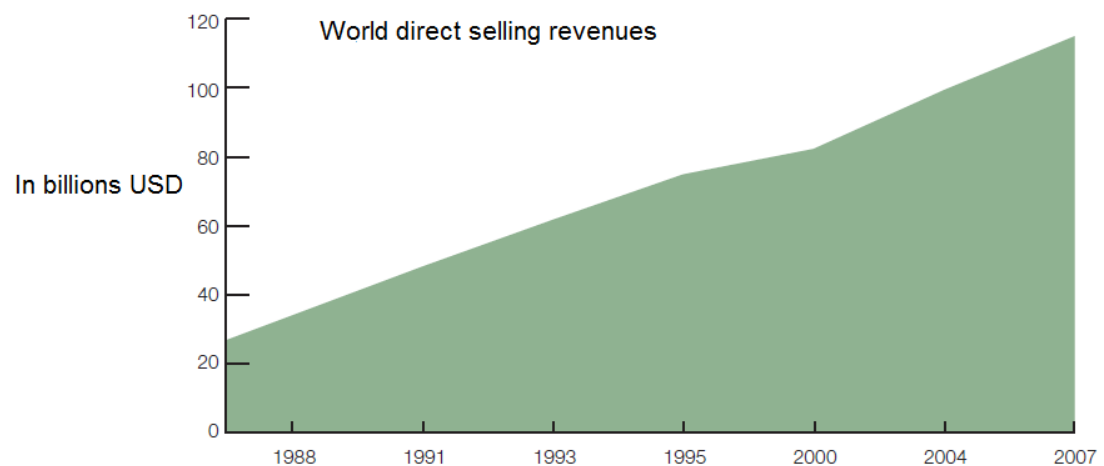
(World Federation of Direct selling Associations, 2012)

**Figure 1:** Number of people engaged in direct selling worldwide



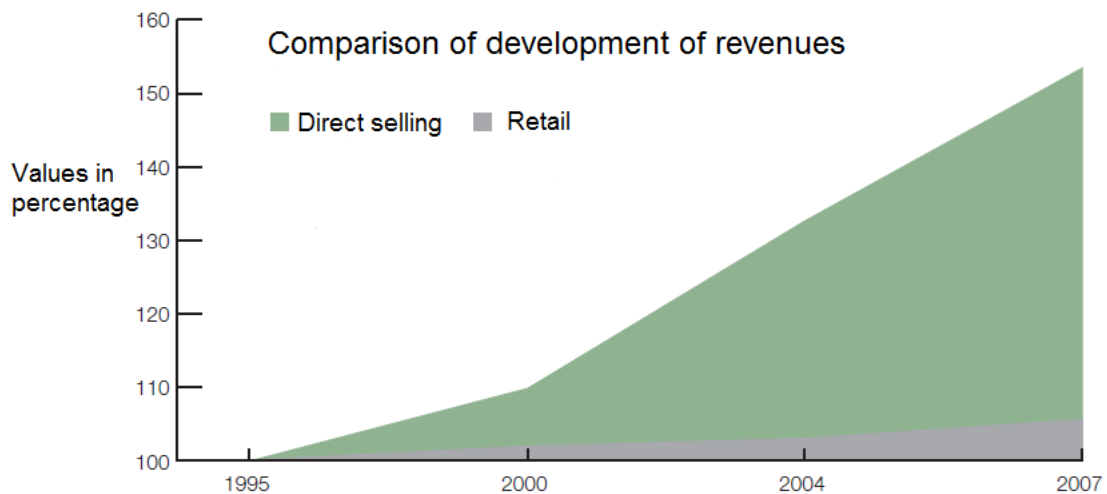
Source: LR Marketing plan brochure – “Návod k úspěchu” 2012, translated from german Branchenreport Direktvertrieb, 2009

**Figure 2:** World direct selling revenues



Source: LR Marketing plan brochure – “Návod k úspěchu” 2012, translated from german Branchenreport Direktvertrieb, 2009

**Figure 3:** Comparison of development of revenues in direct selling and retail



Source: LR Marketing plan brochure – “Návod k úspěchu” 2012, translated from german Branchenreport Direktvertrieb, 2009

### 3.2.1 Direct Selling advantages

**Longlasting seller-customer relationship** – Very positive effect on business has the relationship created during the contact between seller and customer. The effect is much higher as each customer has own seller not who he/she usually knows very well. Because of the depth of the relationship, the business is usually long-term oriented. “According to Kotler the costs on getting a new client are 5 times higher than costs on maintaining current customer. A lot of effort must be done to convince satisfied customer to change the brand and run to different customer. Studies declare that companies can increase from 25% to 85% of profit by decreasing the number of losing current customers by 5%.”

(Kotler, Marketing management, p.54, 1998)

**Shortening of distribution channel** – The aim of direct selling is shortening of the distribution channel. This causes saving of costs and possible decrease of final price.

**Targeting customer needs** – According to Kotler, some years ago marketing more focused on how to get a new client. Sellers were more motivated and paid for getting new customers than for servicing and keeping current customers satisfied. New companies put emphasis on the art of caring current clients. We move from “producing

products” to “producing loyal customers”. The trend is moving from “orientation on transactions” to “orientation to relationships”.

(Kotler, Marketing v otázkách a odpovědích, p.38, 2005)

**Home comfort** – There are particular clients who prefer home comfort. As the goods comes to customer the customer can stay home, in the office or at his/her favourite place.

**Flexibility of sellers** – According to Kotler, key thing in customer’s satisfaction is reaction on potential customer’s complaints. “It is assumed that 54–70% of complaining customers will remain loyal to the company if the complaint is settled. If the complaint is settled promptly then the number of remaining customers increases to 95%. Customer will tell positively about the company generally to 5 other people if the complaint is satisfactory settled.”

(Kotler, Marketing management, p.34, 1998)

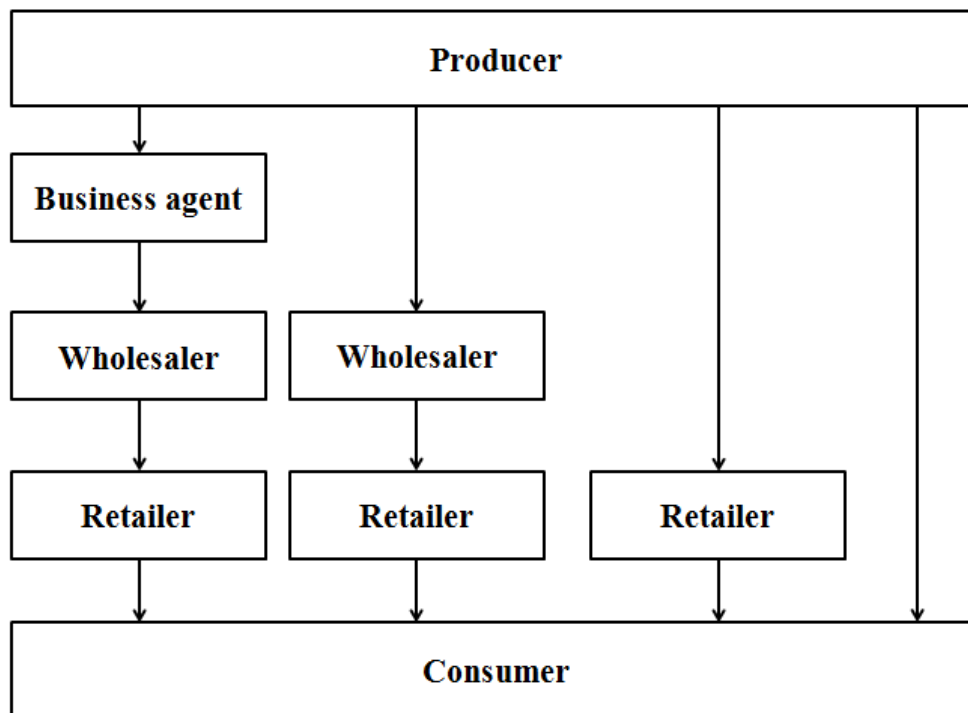
Because of close relationship and high flexibility of single salemen the complaints are settled usually very promptly and kindly.

Záboj mentions that generally proved fact is that distribution channel of zero level (direct selling) allows easier controlling of prices, controlling level of supplied service or goods and higher influence of production company on conditions of selling. Distribution channel of zero level usually is more adaptable towards changes of market situations than other longer distribution channels.

(Záboj, Obchodní operace, p.95, 2007)



**Figure 4:** Distribution channels and their length



Source: Obchodní operace, Ing. Marek Záboj, Ph.D., page 95, 2007

### 3.2.2 Direct Selling disadvantages

**“Unwanted”** – Problem of direct selling is that sometimes can be unwanted for the first time. A client might not be in the need of wanting the product. This might cause a negative opinion about the brand.

**Negative attitude of salesman** – Sometimes the attitude of salesmen can be negative or unprofessional as anyone in general can become direct seller as the investments are low and usually there are no other demands on salesman profile.

**Not outgoing** – Very key role for shopping any product is good feeling. Some clients get a good from out going and buying a product or service on the public place.

### 3.3 Network marketing

**Network** – “different parts of an activity or organization situated in different places but in some way connected to each other”

(Ian Mackenzie, Management and Marketing, p. 119,1997)

**Marketing** – “the process of identifying and satisfying customers’ needs and desires”

(Ian Mackenzie, Management and Marketing, p. 118,1997)

“More precise definition of Marketing by Mackenzie is marketing is the process of developing, pricing, distributing and promoting the goods or services that satisfy such needs. Marketing therefore combines market research, new product development, distribution, advertising, promotion and product improvement.”

(Ian Mackenzie, Management and Marketing, p. 58,1997)

Kotler and Armstrong define marketing as social and managerial process in which wishes and desires of individuals and groups are satisfied in action of production and exchange of products or other values.

(Philip Kotler and Gary Armstrong, Marketing, p.30, 2004)

According to McCarthy and Perreault it is good to divide marketing into micro-marketing and macro-marketing.

Micro-marketing is the performance of activities that look for accomplishing an organization’s goals by anticipating customer or client needs and directing a flow of need-satisfying goods and services from producer to customer or client.

Macro-marketing is a social process that leads an economy’s flow of goods and services from producers to consumers in a way that effectively connects supply and demand and accomplishes the goals of society.

(McCarthy and Perreault, Basic Marketing: A Global-Managerial Approach. p.8-10, 1993)

Chris Taylor describes network-marketing. According to his opinion network marketing can be compared to franchise for ordinary people. There is no similar marketing conception. Costs of starting this business are minimal. Work can be done part-time with your employment. There are no financial risks for you and your family.

The top-roofing company takes care of all business and legal aspects. This means buying and development of products, overhead costs, objects, supply etc.

Therefore the distributors can focus on activities that make profit. Mother company is also stock for goods and performs very well.

(Chris Taylor, Recept na úspěch v síťovém marketingu, p.11, 2011)

### **3.3.1 Network marketing advantages**

Ivo Toman mentions an interesting opinion comparing retailing and network marketing. “Many people think hard about how to get rich. How to earn money, what to do business with, where to invest. Basically how to be an entrepreneur. There is usually a disappointment after all when realizing what means running a business and what it entail. Because in this field can be found not much of money or self-satisfaction however there are many problems. Have you ever thought of what is all necessary to be done when running a business? Have you ever thought of how much trouble accompanies running a department store? There would be needed many long books to be written to cover all worries connected to having a department store.”

However network marketing allows to work: when the distributor wants, with whom the distributor wants, where the distributor wants, with product(s) the distributor wants, the distributor has no fixed-wage costs, the distributor doesn't have to own or rent real estates (initial capital), within the of very low financial capital, while quickly adapting to new situations, without the need of investing a lot of money into finding the best and qualified co-operatives because the business model is established in a sense that good workers become leaders on their own.

(Ivo Toman, Jak budovat multi level marketing: kudy vede cesta a kudy ne, 2006)

### **3.3.2 Network marketing disadvantages**

From the company's point of view, a disadvantage of this economical model is bad name of network marketing. This sometimes causes suspicious reactions among potential customers (some customers might be suspicious about a product, price or a company using system of network marketing).

Rather significant disadvantage for some distributors might be – not having fixed income. In this business distributors are rewarded according to their results. This is very motivating for some individuals. However some individuals might find it hard to deal with it.

### **3.4 Direct selling and network marketing**

There is a big difference between direct selling and network marketing although these two approaches are usually used together. Direct selling is a way how to get a product straight from producer to consumer without any intermediaries. Direct selling can operate without network marketing and vice versa. Network marketing is more of a system for salesmen remuneration. In network marketing there is usually built a network of salesmen and consumers who receive goods directly from producer. Usually for businessman the larger and better performing network build, the better remuneration can be expected.

### **3.5 Retailing**

Interesting facts about retailing mentions Roger Cox. Retailing is a type of acquaintance that everyone has some experience with. Many of us do the shopping nearly everyday, at least window shop. Many potential owners of a businesses are persuaded by this consideration to start a business. As considering that this field ("known field") will be easy way. It is enough to have good mannner, basic skills in dealing with money and you can become another Jack Cohen (founder of Tesco chain). However doing retail in small volume is not easy and it is really a challange. A magic of retailing is that it is very close here to cash box checking every change. This changes are very little changes in customers taste. These changes must be recongnized as they mean success or loss.

(Roger Cox, Jak dobře vést svou vlastní prodejnu, p. 11 1995)

Generally money spent in retail is much higher than money spent within direct selling, however the percentage increase in revenues of direct selling companies is significantly higher compared to increase in retail. In both cases its business in which the sales are dependent on customers satsifaction and choice. In retailing the customer comes to goods which sets the retailer into easier position. Ing. Jana Lyková thinks that selling goods or services is one of the most casual human activities. It is done by every single human or organization that creates offer of products or services. It is possible to say that in easy form selling exists since the beginning of barter of goods and services.

Selling has become separated scientific discipline just in recent history because of economical changes and because of changes in psychology of shopping. For this

discipline specific knowledge, proficiency and attitude is needed. By its hardeness it rapidly differentiates from other disciplines done by employees in company. The seller has never completely under control the result of activity – acquisition of business.

(Lýková, Jak organizovat a řídit úspěšný prodej p.1, 2002)

The negative effect for customer and shop owner is that shop assistants are often not motivated to perform the best they can. Shop assistant has wage per hour and sometimes some amount of the wage is variable depending on the results. In this case the results per head are usually much higher (Baťa, a.s. or ELECTRO WORLD).

On the other hand, retailing in Czech Republic has many advantages and especially the customers habit. Customers in Czech Republic are usually not used to shop anywhere else than in retailing stores. For example online shopping – 44% of people between 25-34 bought at least one thing or service in last year on the internet and in case of people over 65 years only 3% answered positively on the same question.

(Czech statistical office, 2012)

Roger Cox mentions key role of employees. When business raises to certain volume it is nearly impossible to get along without employing other people beside family members. To choose good staff and use them effectively is probably the most important short-run problem in the whole retailing business process. The problem arises from that the owner becomes more of an employer than employee.

Key problem in good co-operation is partly only different characters of employees and moreover legislative arrangements. In past 20 years there have been created many new laws defending rights of employees.

When having good employees there must be good training. Owners of shops and leading employees sometimes consider training as a waste of time because it usually doesn't bring results immediately. However, value of training as an investment into personnel is substantial.

(Roger Cox, Jak dobře vést svou vlastní prodejnu, p. 46-48, 1995)

### **3.6 Selling via existing chain of shops**

Selling via existing chain of shops is another way how to distribute products or services. Advantage is that there are no costs connected to distribution – no rent, no

wages, no electricity etc. The only cost is advertising that is definitely needed because a shop is not unique. By unique is meant that not only one brand is sold. There are many brands sold in such shops – for example perfumeries Marionnaud, Fann, Douglas. These all distribute products of other companies – Dolce & Gabbana, Calvin Klein, Dior, Chanel, etc.

On the other hand, as costs and risk is lower, then the profits are lower. Because the intermediary takes the risk and costs, it takes substantial part profits. This distribution channel shifts the company from producer and distributor to position of producer and supplier.

### **3.7 Internet selling**

Philip Kotler thinks that marketing performed on the internet can be described by word kybermarketing. It means communication and realization of transactions in space of market rather than physical contact. There are three types of companies using kybermarketing. Firstly, these are companies that do on-line business since established as for example amazon.com. Second type are companies that own shops and kyber-space is their second marketing channel. This covers for instance bookshop Barnes&Noble. Third it is companies that sell via phonecalls or catalogues; some of them added selling on the internet. Dell Computer is a typical example.

(Kotler, Marketing v otázkách a odpovědích, p.99, 2005)

Jiří Donát mentions that electronical entrepreneurship is a way of entrepreneurship that followingly integrates all traditional commercial activities. It is framed by combination of older and known regularities of classical entrepreneurship with completely new characters which are brought to entrepreneurship by current possibilities of information and communication technologies. By combination of two such opposite characteristics is obtained very specific mixture of rules. There are rules proved in traditional entrepreneurship; on the other hand, to these rules there are added some completely new particularities that part of these rules are turned over. In this is locked the trickiness and magic of doing business today

( Donát, E-Business pro manažery, p.11, 2000)

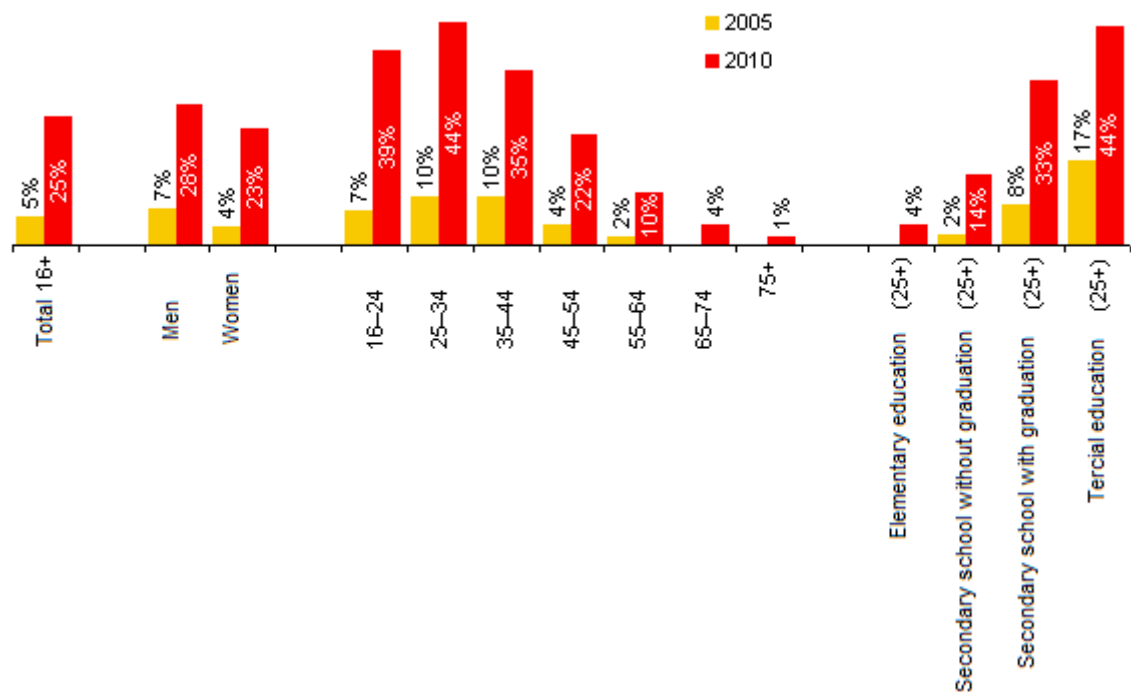
In the second quarter of 2010, 25 % of respondents 16 year and older declared that in past year bought something on the internet. Compared to year 2005 it is 5-times

more as in 2005 only 5% of people 16 years and older declared to buy something on the internet in the past year. Generally men buy more often on the internet (28 %) than women (23 %). In the age scale of 25–34 buy online 44 % of people. The lowest share of people shopping on the internet is among older people. Only 3 % of people 65 yeras old and more bought something on the internet in last 12 months.

(Czech statistical office, 2010)

Nice online shopping indicator is also education. As seen on table below, the higher educated group the more likely to be shopping on the internet.

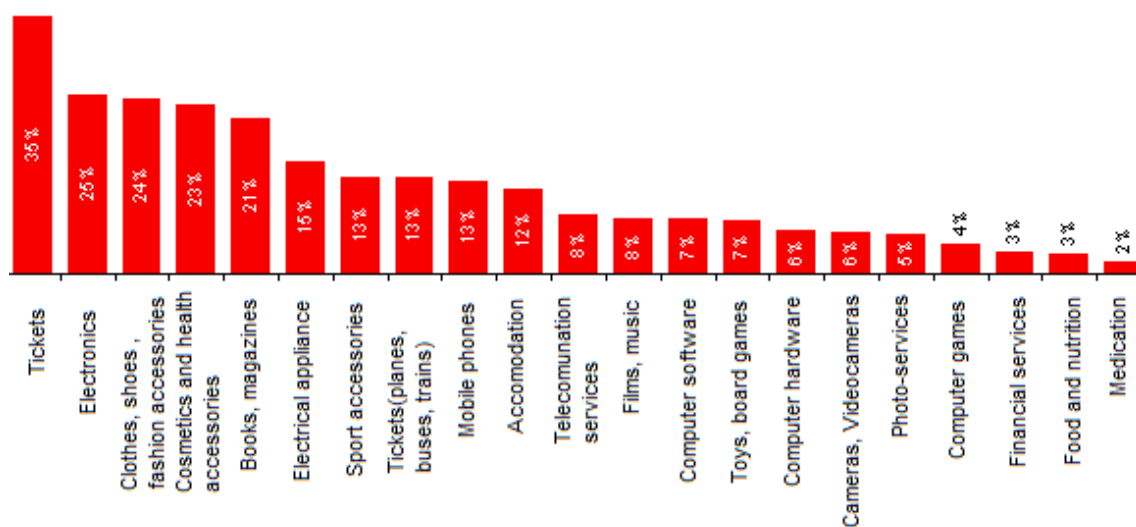
**Figure 5:** Sales of goods on the internet in Czech Republic (years 2005 and 2010)



Source: Czech statistical office, <http://www.czso.cz/>, edited by author

All these statistical figures can be analyzed and internet marketing and advertising campaign can be based on these facts.

**Figure 6:** Goods bought on the internet in Czech Republic, 2 quarter of 2010 (% of people who bought on the internet in last 12 months)



Source: Czech statistical office, <http://www.czso.cz/>, edited by author

A third of those who in the past 12 months bought on the Internet for private purposes ordered tickets (for cultural, sporting or other events), a quarter bought electronics or clothing footwear and fashion accessories.

Usually the goods that women are buying on the Internet includes cosmetics and medical supplies, clothing, footwear and fashion accessories, toys, board games, and books. On the other hand goods purchased by men frequently include computer games, other software, computer hardware, mobile phones, cameras, electronics and sporting.

As in previous years, in 2010 the majority of those who ordered goods or services over the Internet paid for them: 62% of all buyers paid cash on delivery. Payment via internet (credit card, wire transfer via internet banking, through systems such as PayPal, etc.) were used by 38% of all shoppers.

### 3.8 Franchising

Ing. Marek Záboj, Ph.D. defines franchising. Franchising is a method of doing business wherein a franchiser licenses trademarks and methods of doing business to a



franchisee in exchange for a recurring royalty fee. The parties involved typically enter a franchise agreement which binds the parties together through contractual provisions. This is an arrangement whereby someone with a good idea for business (the franchisor) sells the rights to use the business name and sell a product or service to someone else (the franchisee). A franchise agreement will usually specify the given territory the franchisee can use as well as the extent to which the franchisee will be supported by the franchiser (e.g. training and marketing campaigns). However most franchisee agreements do not provide the franchisee with exclusive control over the given territory.

( Zábaj, Obchodní operace, 2007 )

## **4 Methodology**

At the beginning of practical part the mother company LR Health & Beauty Systems GmbH and subsidiary company LR Health & Beauty Systems, s. r. o. are described. Followed by company business philosophy and description of price creation. Creation of price allows to analyze different distribution channels by cost-benefit analysis method and decide about its effectiveness for company and its customers. Analyzed distribution channels are: selling the products via existing chain of shops, selling the products via e-shop, franchising, chain of shops creation. Every of distribution channel is described and compared to current distribution channel – direct selling.

For elaboration of the thesis secondary and primary data were used. The secondary data were acquired from internet sources and books. These data were not sufficient to elaborate the thesis therefore primary data had to be collected from the customers. These data were collected in a form of marketing research via questionnaires distributed to customers. The questionnaires were collected in October 2012. This questionnaire was performed face-to-face and immediately after consultation of LR Health & Beauty Systems consultant. The LR Health & Beauty Systems consultant asked questions and noted the answers in order to make the questionnaire as easy and quick as possible. The result of the questionnaire should bring results about how the customers perceive the LR Health & Beauty Systems brand. Questionnaire was filled by the sample of 100 respondents (customers).

### **4.1 Cost-benefit analysis**

The method used is cost-benefit analysis. The method can be applied to anything however usually is applied to financial decisions. According to mindtools.com Jules Dupuit, a French engineer, first introduced the concept of Cost-Benefit Analysis in the 1930s. It became popular in the 1950s as a simple way of weighing up project costs and benefits, to determine whether to go ahead with a project. As its name suggests, Cost-Benefit Analysis involves adding up the benefits of a action, and then comparing these with the costs associated with it.

This method is more or less used in the whole practical part – calculating the benefits and costs of possible distribution channel.

## **5 Practical part**

### **5.1 Company description**

LR Health & Beauty Systems GmbH is a worldwide company operating in 32 countries. The company was established by Helmut Spikker and Achim Hickmann in 1985 in Ahlen, West Germany. The company yearly revenue is approximately 410,000,000 euro (10,250,000,000 CZK).

Production includes wide portfolio of self-made products such as perfume, skin care products, cosmetics, jewelery, accessories, nutritional supplements for people and animals. The perfume brand also includes the Star-box concept (since 2001), which had begun with own fragrance line of Michael Schumacher. In following years additional fragrance creation with names of internationally known people such as Heidi Klum, Boris Becker, Ralf Moeller and regional brands such as Ian Thorpe or Karel Gott have been performed. In 2009 followed with Leona Lewis, Marcus Schenkenberg and the four Desperate Housewives. In July 2010, LR created Bruce Willis fragrance line. From September 2011, is the wife of Bruce Willis, Emma Heming Willis, star and designer for the new product segment jewelry "LR.Joyce" work. The prominents coopertaion is both sided – the celebrity not only brings famous name however also participates on product creation. This is unique and ensures personalization with the product. LR Health & Beauty Systems is well-known thanks to its attitude to quality. Therefore the company still operates and produces in Germany.

The company employs about 1,000 employees and cooperates with 300,000 independent LR partners worldwide. Currently, the company is managed by the management to Jens Abend (Chief Executive Officer), Tilo Ploger (Chief Operating Officer), Andreas Rutsch (Chief Financial Officer) and Thomas Heursen (General Sales Director).

The products are sold directly to the customers. Marketing of direct sales is one of many manners how to reduce costs accompanied to products distribution. By saving magnificent costs – advertisements, wholesalers fee and mainly retail business fees - the company invests the money into quality materials, effective science-research, motivational revenues for LR partners and mainly cheaper product for a customer. The company uses business model – so-called network marketing, also known under the

term multilevel marketing. This is not the way how to distribute the product. This is the way how to motivate and reward workers according to the performance. More than 300,000 independent LR partners in Europe are connected to the distribution system. However, part of the partners operate as distributors while other partners purchase products solely for personal use.

The LR Health & Beauty Systems GmbH is mother company to LR Health & Beauty Systems, s. r. o. established in Ostrava – Hrabůvka. The Czech subsidiary company was established in 1993 by Ing. Aleš Buksa. The subsidiary company is operating on Czech and Slovak market. The yearly revenue is approximately 900,000,000 CZK. The subsidiary company makes about 8,78% revenue of the company. In Czech market. About 80% of this revenue is made in Czech Republic and 20% is made in Slovakia. The approximate yearly revenue of Health & Beauty Systems, s. r. o. in Czech Republic is 720,000,000 CZK.

## **5.2 Situation analyse**

Situation analyse deals with inside and outside factors of a company. This paper focuses on the company itself and its customers via analyzing its distribution channel. Very key is to describe the company's business philosophy. Then a questionnaire is analyzed as it refers to customers preferences.

### **5.2.1 Company business philosophy**

The LR Health & Beauty Systems's business approach has been developing since the company was established in 1985. For first 4 years the company used retailing as a way of distribution and was selling the products via retail shops. During these 4 years the company made revenue of 15,000,000 DM (Deutsche Marks - German Marks - cca 7,500,000 Euro). In year 1989 the company decided to change the business model to model of direct sales and network marketing. Using the distribution model of direct sales the company has made 45,000,000 DM (cca 22,500,000 Euro) revenue in 1990. In 1991 the company made revenue of 102,000,000 DM (cca 51,000,000 Euro). This rapid increase in sales showed that the decision was right for the company for that moment. Direct sales and network marketing has been used since that moment till today and the revenues are steadily growing all over the world despite the economical crisis.

The very key factor about LR Health & Beauty Systems's marketing is shortening the process of products distribution. Based on the revenues it seems to be an efficient distribution channel for the company and its customers too. The effectivity is especially for customers who receive products of high quality for lower price. This allows the company keep low prices, buy ingredients of high quality and reward highly company's partners.

LR partner has usually more time for explanation of quality and how to use the products properly than a shop assistant. A customer gets large service in the price of the product – a customer is advised by LR partner about the products at nearly any time. The partner is highly motivated to satisfy the clients needs. Motivation of a shop assistant depends on the wage system. Some retailing companies use partly provisional wage system as the shop assistants are more motivated to satisfy the customer.

LR partners have high level of training and knowledge. On the other hand negative effect for customer might be that not all LR partners keep high amount of stock. The delivery usually takes 2 days so customers who want to buy a product immediately might find it a little difficult to order the goods in advance.

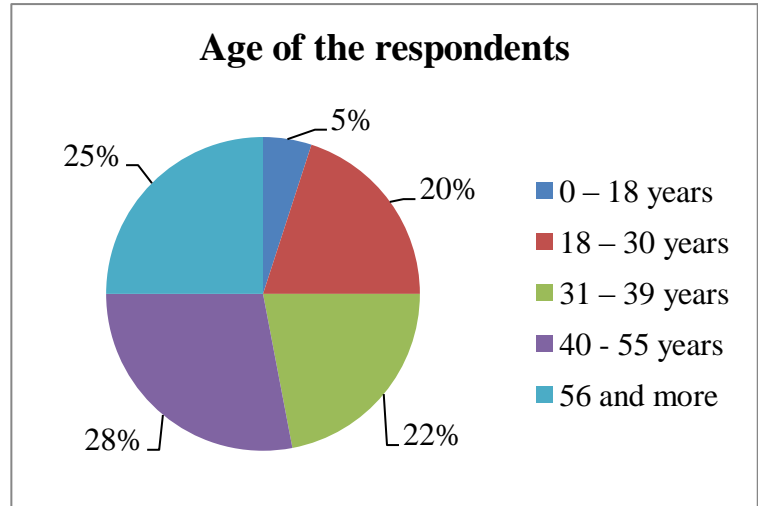
### **5.2.2 Marketing survey – questionnaire**

For further analysis of the company LR Health & Beauty Systems the data about perception of the company needed to be analysed. These data were collected in a form of marketing research via questionnaires distributed to customers. The questionnaires were collected in October 2012. The questionnaire consists of 10 questions. This questionnaire was performed face-to-face and immediately after consultation of LR Health & Beauty Systems consultant. The LR Health & Beauty Systems consultant posed questions and noted the answers in order to make the questionnaire. The result of the questionnaire should bring results about how the customers perceive the LR Health & Beauty Systems brand. Questionnaire was filled by the sample of 100 respondents (customers). The questions and answers of customers are shown in figures below.

1. Age:

- 0 – 18 years
- 18 – 30 years
- 31 – 39 years
- 40 - 55 years
- 56 years and more

**Figure 7:** Age of respondents



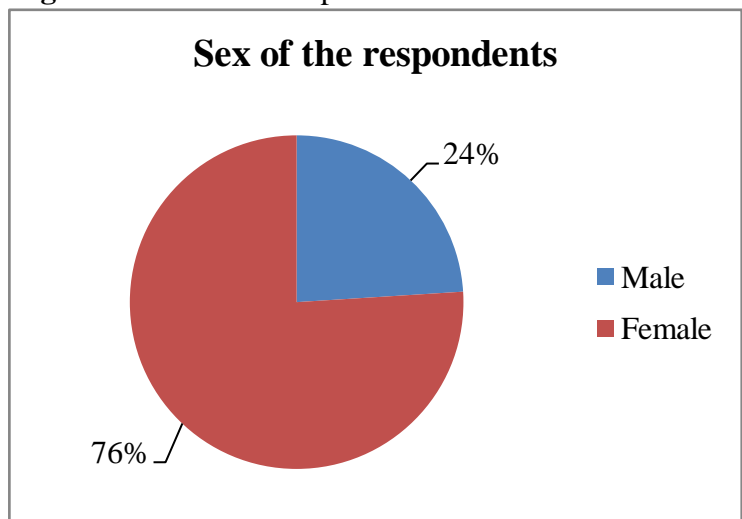
Source: Questionnaire survey, 10/2012; n=100

The distribution of customers according to age is divided into 4 main categories with more or less similar number of customers. This question shows that 75% of customers are 31 years old and more. Only 5% of respondents were younger than 18 years old.

**Figure 8:** Sex of the respondents

2. Sex:

- Male
- Female



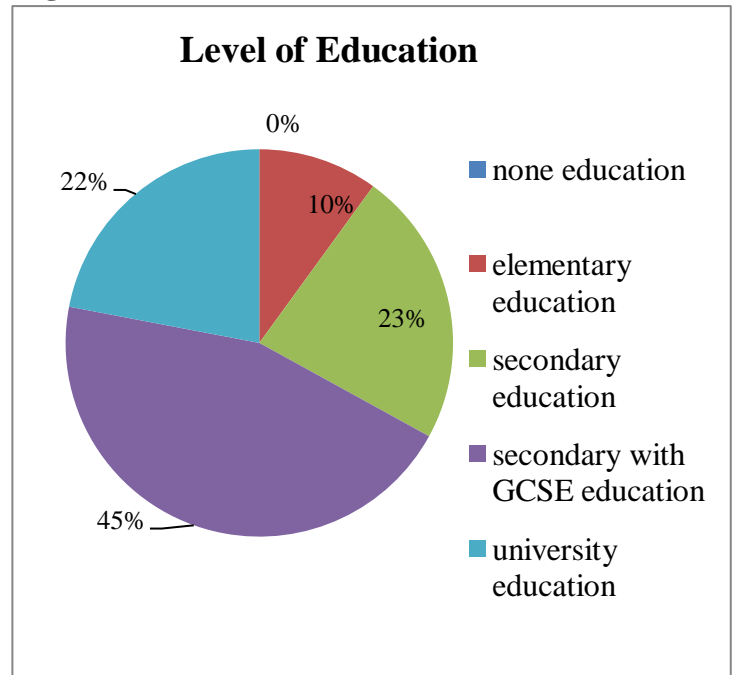
Source: Questionnaire survey, 10/2012; n=100

Second question shows that majority (76%) of customers are women and minority (24%) are men. This result could be expected as the assortment is focused on health and beauty.

3. The highest achieved education:

- none education
- elementary education
- secondary education
- secondary with GCSE education
- university education

**Figure 9: Level of education**



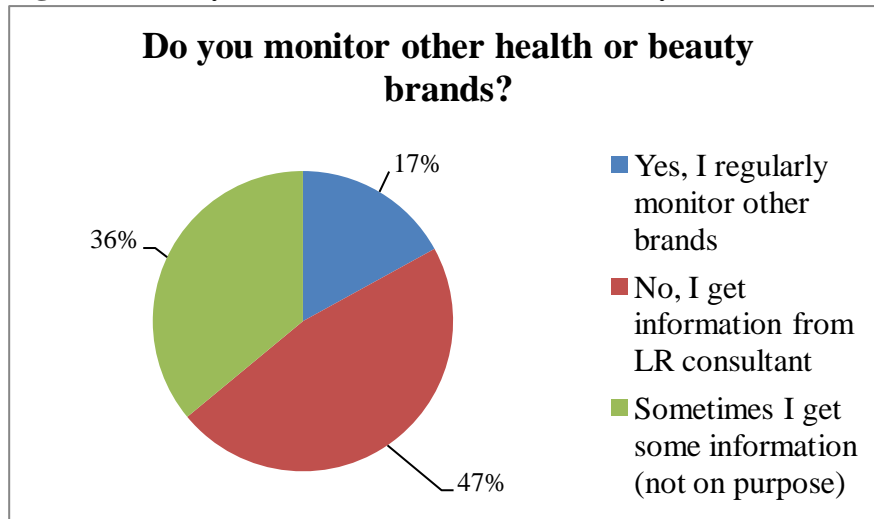
Source: Questionnaire survey, 10/2012; n=100

Third question focuses on education. Majority (45%) of respondents are secondary school with GCSE educated. Similar proportion of customers are university educated(22%) and secondary education without GCSE (23%) educated. None of the respondents was without any education at all.

4. Do you monitor other health or beauty brands?

- Yes, I regularly monitor other brands
- No, I get information from LR consultant
- Sometimes I get some information (not on purpose)

**Figure 10:** Do you monitor other health and beauty brands?



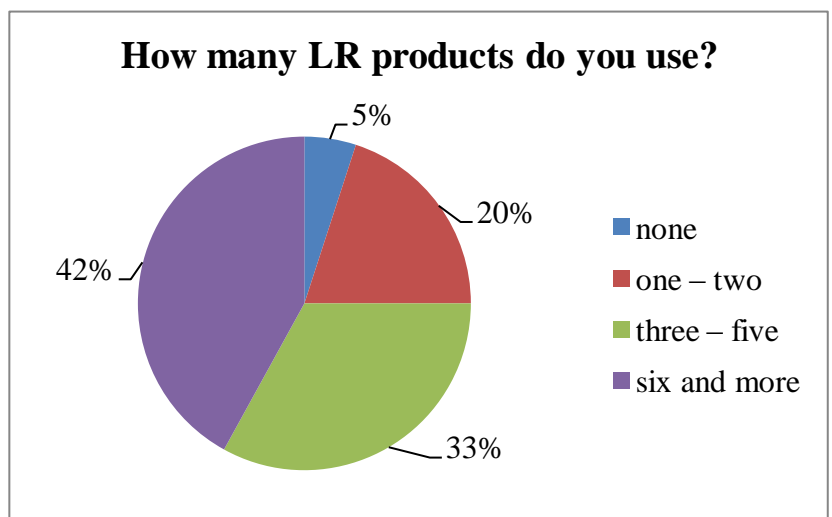
Source: Questionnaire survey, 10/2012; n=100

Question number four deals with other brands monitoring – if the customers search for more information than the consultants provides. Most of the clients (47%) do not search for more information. One third of customers mentioned that not purposely are informed by adverts, friends or any other way. And 17% of respondents regularly purposely seach for more information from other brands.

##### 5. How many products do you use?

- none
- one – two
- three – five
- six and more

**Figure 11:** How many LR products do you use?



Source: Questionnaire survey, 10/2012; n=100

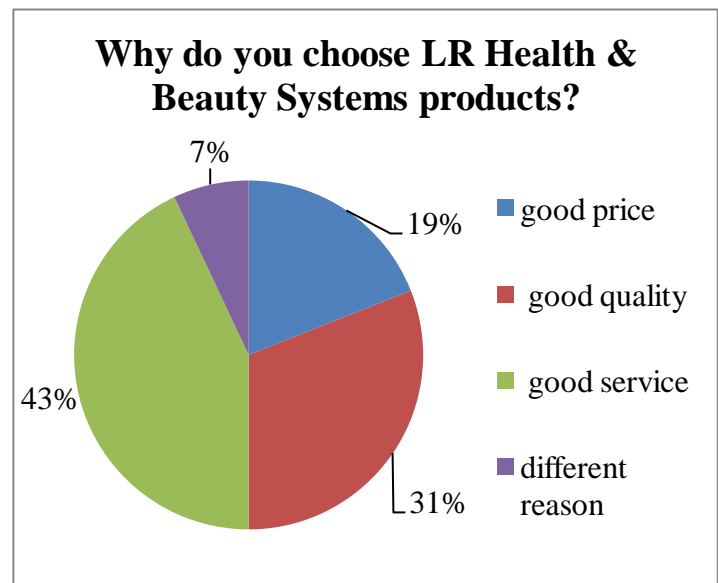


Another question is about usage of products. If the customers use none, from one to two, from three to five, six or more products. The highest proportion (42%) of respondents answered 6 or more products. More than half of clients(53%) uses between one and five products from company LR Health & Beauty Systems. And 5% of clients didn't use any LR Health & Beauty Systems's products at all. This seems to be rather surprising however these were new clients haven't used any product so far.

6. Why do you choose LR Health & Beauty Systems products?

- good price
- good quality
- good service
- different reason:.....

**Figure 12:** Why do you choose these products?



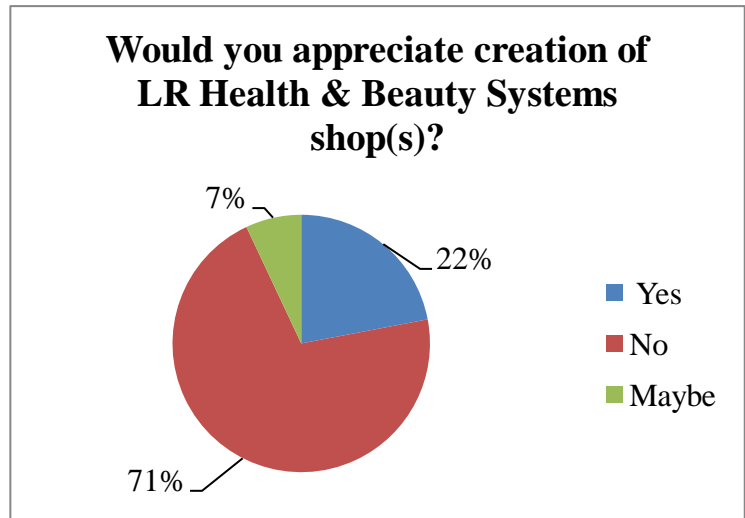
Source: Questionnaire survey, 10/2012; n=100

Question six is very interesting from customers preference point of view. The most important according to respondents is good service as 43% of respondents chose this as a reason to buy these products. Good quality is decisive for 31% of customers followed by good price with 19% of respondents. Different reason stated 7% of respondents – the main different reason chosen by all 7 respondents was comfort of home shopping.

7. Would you appreciate creation of LR Health & Beauty Systems shop(s)?

**Figure 13:** Creation of shops

- Yes
- No
- Maybe



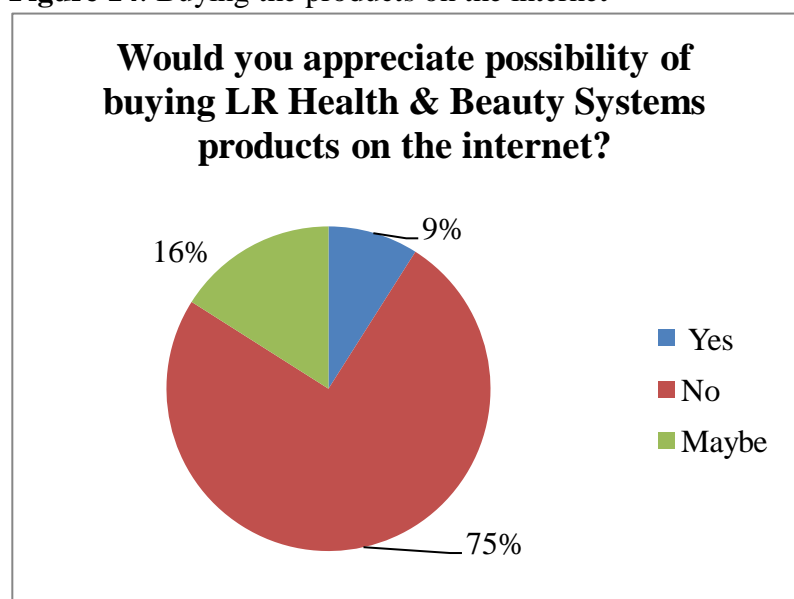
Source: Questionnaire survey, 10/2012; n=100

Question seven is about creation of LR Health & Beauty Systems shop(s)? Suprisingly high number of 71% respondents declined this possibility. Suprisingly high number is effected by the fact that many is questioned customers are long-term clients and are used to given model of shopping. Only 22% customers would welcome opening shop(s). The rest 7% answered maybe as they could not imagine the effects.

8. Would you appreciate possibility of buying LR Health & Beauty Systems products on the internet?

**Figure 14:** Buying the products on the internet

- Yes
- No
- Maybe



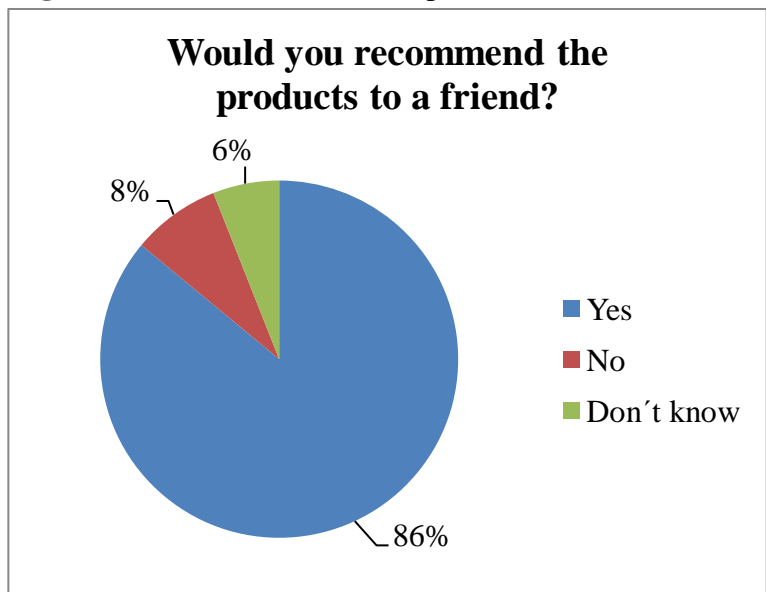
Source: Questionnaire survey, 10/2012; n=100

The respondents showed disinterest in buying the products online as 75% declined this possibility. Minority of 9% of customers would welcome this possibility and 16% stated maybe. This is very important factor and will be used in further analysis.

9. Would you recommend the products to a friend?

- Yes
- No
- Don't know

**Figure 15:** Recommendation of products



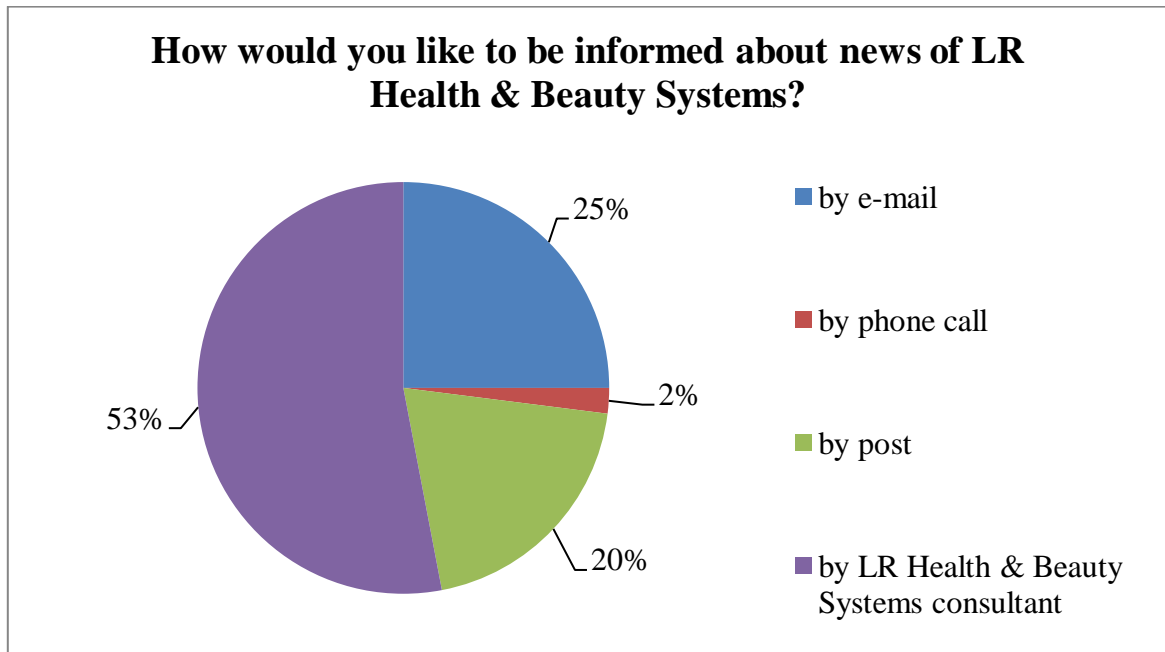
Source: Questionnaire survey, 10/2012; n=100

Question nine deals with product recommendation. Majority of respondents (86%) would recommend and probably do recommend the products to friends. Interesting is 8% of respondents who wouldn't recommend the products. I asked one respondent why wouldn't she recommend the products while she uses them for long and like them very much. Her response was: "I want to keep them for myself".

10. How would you like to be informed about news of LR Health & Beauty Systems?

- by e-mail
- by phone call
- by post
- by LR Health & Beauty Systems consultant

**Figure 16:** How would you like to be informed about news of LR Health & Beauty Systems?



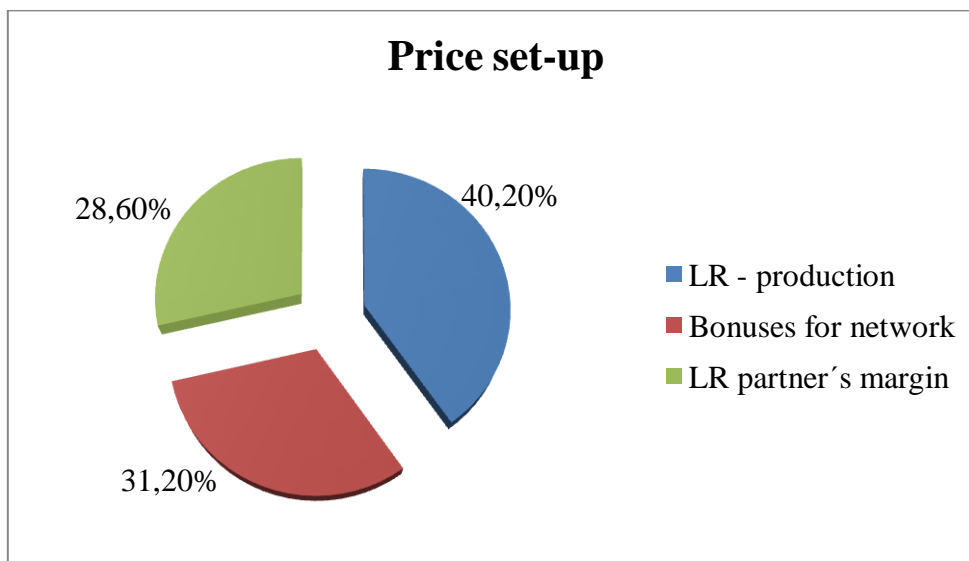
Source: Questionnaire survey, 10/2012; n=100

The last question in questionnaire focuses on customer receiving information. More than half (53%) of respondents prefers to be informed by consultant. One quarter of respondents prefers to be informed by e-mail, 20% of clients would like to be informed by post and only 2% of customers would prefer phone call.

### 5.3 Price of the product

Price of the product is very key parametr. Today the price of the products is created from three parts: LR production of the product (40,2%), bonuses for network (31,2%), margin for LR partner (28,6%). Of course in the part of LR-production are covered fixed costs, variable costs and profit of the company. Fixed costs per unit produced are decreasing dependantly on the volume of sales and production.

**Figure 17: Price set-up**



Source: LR Marketing plan brochure – “Návod k úspěchu” 2012, edited by author

For the analysis all other conditions must remain the same – under the law of *ceteris paribus*. This means that the price must remain the same. There is 59,8% value of the sold products to cover all the costs in new business strategy. There are 4 options analysed – adding goods to some existing chain of shops, selling products via internet, creation of chain of shops or franchising distribution.

## **5.4 Goods on stock**

Today the mother company LR Health & Beauty Systems GmbH keeps continuously goods on stock worth of 10 million Euros. Subsidiary companies keep some amount of stock as well. Australian subsidiary company keeps larger stock than Czech or French subsidiary companies as the destination is much longer. Czech LR Health & Beauty Systems, s. r. o. keeps stock in value about 30,000,000 CZK. If there was 20 small shops around Czech Republic the stock in total would have to be higher. In prediction it would be about 2,500,000 CZK per shop, so in total 50,000,000 CZK.

### **5.5.1 Selling the products via existing chain of retailers**

This business alternative might seem rather efficient and „easy“ from the first sight. After analyzing the company LR Health & Beauty Systems, s. r. o. First of all the company has over 1,000 products in its portfolio and such a large portfolio can hardly be fitted into some other shop. Secondly the company name could be damaged by lower

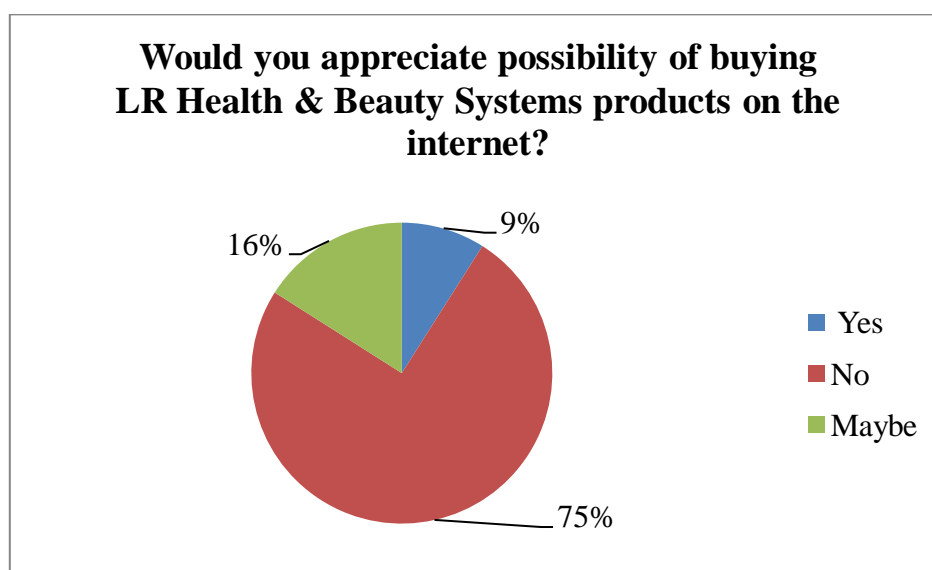
level services for clients as it would be nearly impossible for shop assistants to learn sufficiently about all the products (+ original products in the shop). Moreover, it would be harder to react flexible on the demands of the market as the company wouldn't be selfgoverned.

### **5.5.2 Selling the products via e-shop**

Selling the products online is distribution channel that is recently more and more often used. There is one clear explanation. It rapidly decreases the costs for the seller. No main astronomic main street rent to be paid, no set opening hours, there is even no need for „posh“ looking shop. The company LR Health & Beauty Systems, s. r. o. doesn't sell any of their products on the internet and never did. It is completely against the philosophy of the company because at LR Health & Beauty Systems, s. r. o. there is on the first place quality and service for the customers, not the cheapest price. The contact and relationship with a client is essential for this company ever since. This is the key factor for LR Health & Beauty Systems, s. r. o.'s success. Based on general analysis distribution system via e-shop doesn't seem as a very effective way for LR Health & Beauty Systems, s. r. o. at the moment.

Very important is opinion of clients about preferred access to given goods and services. In the questionnaire the question about internet selling was: “Would you appreciate possibility of buying LR Health & Beauty Systems products on the internet?”. The respondents reacted in 9% yes, 16% maybe and major of 75% no – see on graph below. This clearly shows that the internet distribution system is not preferred by current customers of LR Health & Beauty Systems at this moment.

**Figure 18:** Possibility of buying the products on the internet



Source: Questionnaire survey, 10/2012; n=100

### 5.5.3 Franchising

Franchising is a another way how to distribute products and collect profits for the idea and way of doing business. Usually fast food chains use franchising for quick and efficient spreading of their business all over the world. Nowadays there are not many well know companies operating in the same field of business where LR Health & Beauty Systems, s. r. o. – health and beauty that would be using franchising distribution system to distribute their products. In Czech Republic well known brands for selling beauty products (perfumes and cosmetics) via chain of shops are: Douglas, Marionnaud, Fann and none of these companies use distribution system of franchising.

Analyzing health market, is the other half of LR Health & Beauty Systems, s. r. o.'s assortment. The main dealers of nutrition and health supplements are pharmacies. Larger chains such as Dr. Max is owner and oprator of all 218 pharmacies located on the Czech market. Another large chain of pharmacies Lékárny Lloyds, s. r. o. is owner and operator of all pharmacies too.

A company that uses succusfully franchising distribution channel in the field of cosmetics is Yves Rocher. According to Yves Rocher there is 18 franchising shops in the Czech Republic today. Investment for franchisee is about from 1,300,000 CZK to 1,800,000 CZK for stock, depending on the size of the shop. Entrance fee is 100,000 CZK and must be paid in the moment of agreement signature. Rent, electricity

and other energy is paid by franchisee. Other investments represent the construction works, purchase of furniture or equipment of beauty salon. These investments are paid either by franchiser or by franchisee depending the type franchising licence. There are two types of franchising contract with Yves Rocher – bonded franchising or pure franchising. Bonded franchising is a less expensive type of franchise where the franchisee subtenants. Tenant is Yves Rocher, s. r. o. All payments (rent, electricity) are then over-billed franchisee. Other investment related to construction works, furniture or even invest in cosmetic cabins pays Yves Rocher s. r. o. Pure franchising contract is more suitable for example for the candidate that has its own commercial premises or has the possibility of favorable lease office place. Other investments represent construction works, purchase of furniture or equipment of beauty salon.

The calculation for LR Health & Beauty Systems, s. r. o.'s franchising distribution channel is calculated from the costs for construction works, purchase of furniture or equipment of beauty salon. There will be larger costs on administrative body of the company dealing with arranging franchise contracts. The highest costs for the franchiser company will be advertising supportative campaign. The costs are calculated for the same process as in the case of creation of chain of shops for LR Health & Beauty Systems, s. r. o.

**Table 1** – Franchise creation costs

<b>Shop creation costs – for LR Health &amp; Beauty Systems, s. r. o.</b>		
<b>Regular costs</b>	<b>monthly costs (CZK)</b>	<b>yearly costs (CZK)</b>
Rent	franchisee costs	franchisee costs
Employees Salary	franchisee costs	franchisee costs
Advertisement	227,000	2,724,000
Cleaning Services (inside the store)	franchisee costs	franchisee costs
Insurance	franchisee costs	franchisee costs
Other costs( repairs etc..)	5,000	60,000
Accounting costs	3,000	36,000
Costs for wasting unsold products, cost of having more goods on stock	franchisee costs	franchisee costs
Electricity, water and heating	included in rent	included in rent
<b>Total costs</b>	<b>235,000</b>	<b>2,820,000</b>

Source: Created by author



**Table 2** – Franchise start-up costs

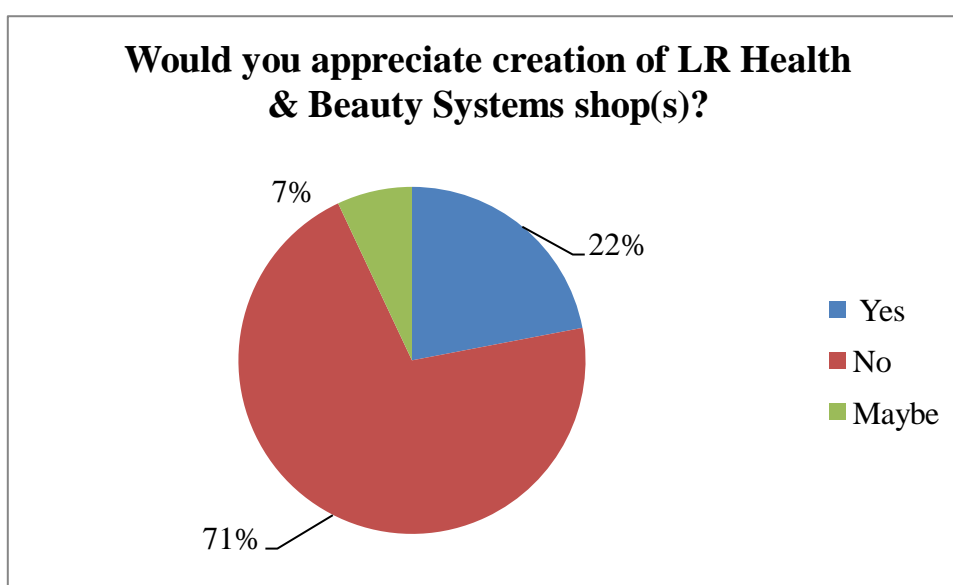
<b>Shop creation costs – for LR Health &amp; Beauty Systems, s. r. o.</b>	
<b>Start up costs</b>	<b>CZK</b>
All the equipment and accessories for new shop	300,000
Advertisement	400,000
Employees training	franchisee costs
<b>Total costs</b>	<b>700,000</b>

Source: Created by author

#### 5.5.4 Shops creation

The two main methods for elaboration of the thesis are marketing research (questionnaire) and cost-benefit analyse. The marketing research is very effective way how to find out customers needs. In the questionnaire there was a important question (**Figure 11**) about creation of shops: “Would you appreciate creation of LR Health & Beauty Systems shop(s)?” The reaction of customers was 22% yes, 71% no and 7% maybe. If neglected the maybe answers the propriton between no and yes is more then 3-times more. This shows that 71% of asked customers wouldn't prefer to go for LR Health & Beauty Systems products into a shop.

**Figure 19:** Would you appreciate creation of LR Health & Beauty Systems shop(s)?



Source: Questionnaire survey, 10/2012; n=100

The analyse of costs and benefits in case of creation of shops is rather complex. If the company decided to change its marketing strategy (switch to retail) then the company would immediately loose all of its 300,000 independent partners. These partners have very close bonds with their customers. This is a very risky step. It might cause decrease in sales and such a step couldn't be taken back. The customers are usually buying the goods because of the treatment that is included. The main role is individual face to face contact and relationship between the LR partner and the customer. The customer can contact the partner at any time and ask about the product and its effects. This makes the LR partner and customer relationship special compared to retailers. From human point of view such change seems unthinkable however it will be analysed from economical point of view.

All the costs connected to creation of a hypopthetical shop for LR Health & Beauty Systems, s. r. o. products need to be calculated. The costs are calculated for one single shop. Afterwards results of calculations can be applied on whole company operating in Czech Republic. It must be taken into account that is not preffered way of distribution by LR Health & Beauty Systems, s. r. o. business plan. The company was operating via single trade units from 1985 till 1989 and found out afterwards that it is not the most effective business model for the company for that moment.

First important aspect is to realize how big shop the company would need. The company would need a large shop. If taken into account size of the portfolio which offers LR Health & Beauty Systems, s. r. o. to Czech customers. There is about 1,000 products in every month offer + special offers such as Christmas or summer holiday products. The size of the shop would have to be about 200m<sup>2</sup>(this size includes the stock).

Secondly must be decided where the shop would be located. The company offers luxury products with brands such as Michael Schumacher, Heidi Klum or Bruce Willis. Therefore the shop needs to be located at some place corresponding to these unique brands. There are a few places in Brno and surroundings that could match the standard – Brno city-centre, Galerie Vaňkovka, Olympia, Tesco Královo Pole, Campus Square. According to real estate agency [www.sreality.cz](http://www.sreality.cz), the price for m<sup>2</sup> differs significantly from 1,000 CZK/ m<sup>2</sup>/ month to 2,500 CZK/ m<sup>2</sup>/(or even more). Usually the trend is the smaller the shop is the higher price for m<sup>2</sup> is. The Brno city center tends to be cheaper than the Olympia shopping mall. For example a small shop of size 50 m<sup>2</sup> in

Olympia costs 100,000 CZK / month which means 2,000 CZK/ m<sup>2</sup>/ month. Renting commercial place in Brno-city center costs about 1,500 CZK/ m<sup>2</sup>/ month. The prices differ significantly (many factors that affect the price). Visibility and accessibility of the shop from the street, size of the shop, how crowded the place is, if there was a well-known shop, how far is a parking place etc. For the purpose of the thesis it was decided to take the low-average price (based on larger size of the shop) 1,600 CZK/ m<sup>2</sup>/ month. The shop size is 200 m<sup>2</sup> therefore the monthly rent is 200x1,600 CZK = 320,000 CZK.

The employees have to understand the fact that the better the sales are the better can be paid. This would be connected to encouraging sales systems. Variable part of wage would be highly affected by the sales made by different employees. This motivational system uses many smaller or larger retailers. To name one for all Baťa, a.s., the shoe producing and selling company. This motivational wage system is hardly countable and estimatable on a single shop assistant so the costs are counted on average. For the shop there needs to be 3 shop assistants at the same time for more frequented hours. The consultation of LR Health & Beauty Systems's product is time consuming and if there were more clients in the shop no-one would assist the customers. Two shop assistants within the less frequented time – from Monday till Friday from the opening time till 3pm. The usual day can be divided into 2 working shifts. Both 6 hours long. First shift is from 9 a.m. till 3 p.m. and second from 3 p.m. till 9 p.m – this means the shop needs two 12 men working hours from 9 a.m. till 3 p.m. and from 3 p.m. till 9 p.m. 18 men working hours till closing. This is 30 men working hours a day. Monthly demand of men working hours is 900 (as 30 days a month multiplied by 30 working hours a day). The shop needs 6 regular workers because one regular worker works 160 hours a month. According to Czech statistical office the average gross wage in Czech Republic is 24,126 CZK. However two thirds of Czech workers don't achieve this level. Therefore it is supposed it wouldn't be a problem to find skilled and enthusiastic workers that would be willing to work for 19,000 CZK (gross wage). Total employee monthly costs are 6 x 19,000 = 114,000 CZK / month.

Cleaning the shop is very important for the shop too. Supposed daily cleaning takes two hours – one hour of cleaning costs 150 CZK. This means for the shop cost of 4,500 CZK / month ( 30 x 150 CZK).

According to Allianz, a.s. financial consultant estimates the insurance paid per one shop would be – 50,000 CZK / year.

Very important factor for any company is advertisement. Today for LR Health & Beauty Systems, s. r. o. the classical advertisement is not really needed because all the LR partners are “advertisement themselves”. Used advertising technique is word of mouth which is generally considered as the most efficient kind of promotion. The company marketing plan encourages people share their good feelings about the products. The partners that share their experiences are highly rewarded. Therefore the company can save high amount of money on classical advertising campaigns and pay these money to its partners. This is also the reason why company LR Health & Beauty Systems, s. r. o. doesn't prefer chain of shops as a way for selling the products. Shortening the process of products distribution is highly effective in order to keep distribution costs low.

The shop would benefit from work that has been done by LR partners in Czech Republic for last 19 years. Most of the clients wouldn't be willing to pay higher price due to all the costs that are included in retail distribution. Most of the clients wouldn't settle for the shop as there would be lack of services that they are used to get. However there would be many customers that are used to the product and would be willing to pay a little more and shop these products in local shopping mall.

The calculation of advertising costs is following – all kinds of media might be used – bigboards, TV, magazines, internet, etc. This is very, very costly. For example not main one page of advertisement in ELLE magazine costs 220,000 CZK. Every famous fragrance has usually advertisement in many magazines similar to ELLE. Therefore the costs should be multiplied by three different magazines of similar status therefore of same price. The magazine is printed periodically every month. So yearly advertising costs on advertising in ELLE magazine are 2,640,000 CZK. The costs for magazine advertising must be divided by 20 shops. Therefore monthly cost per shop on magazine ELLE advertising campaign is 11,000 CZK and yearly cost is 132, 000 CZK. The whole magazine advertising campaign is multiplied by three. Therefore monthly cost shop on whole magazine advertising campaign is 33,000 CZK and yearly cost is 396, 000 CZK. This type of advertising would be very useful if the company decided to open chain of many shops all over Czech Republic. Then the costs can be divided by the number of shops. However focus on local advertising is key for the shop. Very efficient type of advertising campaign is facebook or any other internet server that is crowded (google, seznam, etc). In case of facebook, the advertising company can target

the consumer by selecting location, age or sex. This type of promotion should definitely be used because of high diversity of products portfolio. This way cosmetics and perfumes advertisements could hit the targeted younger generation of potential customers. Healthy supplements could be aimed at older customers that have higher potential of interest in such products. This advertising campaign costs 3 CZK per click. Click is counted down when any of potential clients clicks the advertisement (banner) and is redirected to the advertised web page. There are daily restrictions set on how much money the company wants to invest. Reasonable amount of clicks for the shop would be about 500 clicks per day. This will cost the shop 1,500 CZK / day. This means monthly costs of 45,000 CZK and 540,000 CZK per year. This can't be the only way how to promote the shop. There has to be at least one more or two more ways how to advertise the products and the shop needs to target different group than the one that would be targeted by internet campaign. Well-known way how to make people aware of your brand is bigboards campaign. According to the BigMedia (the largest bigboard company in Czech Republic) one regular bigboard costs about 25,000 CZK / month. Based on observation experiences the shop would need 5 bigboards over Brno city. Monthly cost is therefore 125,000 CZK and 1,500,000 CZK / year. These will be static campaigns. One more effective campaign should be suggested. Aiming towards the consumers. Two trained and good-looking promoters or hostesses would promote the shop itself directly in the shopping mall (or outside) by leaflets, vouchers or some small gifts. Calculation of this advertising campaign is – two promoters or hostesses would work each 10 hours a day for 100 CZK / hour three times a week. This means 6,000 CZK for 60 mens hours in a week, 24,000 CZK / year and 288,000 CZK / year. All the advertising costs together are monthly 227,000 CZK (33,000 + 45,000 + 125,000 + 24,000) and 2,724,000 per year.

Special category of costs is start up costs. These costs paid one time only at the beginning usually during first two months. Special advertisement must take place at the beginning for first month and month before the opening. The radio advertising campaign would be on two different radio stations – Kiss Hády and for example Free radio to ensure attraction of different social and economical groups. This special advertisement would cost 400,000 CZK as radio advertisement seven times a day on radio Kiss Hády costs 50,000 CZK / fortnight, 100,000 CZK / month, therefore as there would be advertised on two radios means 200,000 CZK/month. The shop needs to be

advertised for two months therefore 400,000CZK. Other important start up costs are equipment and accessories. The calculation of equipment and accessories for 200m<sup>2</sup> luxury shop is 300,000CZK (included the costs for stock). The probably most important start up cost would be employees training. These costs can be reduced by efficient employees selection. As today there is high unemployment there are many skilled workers waiting for the job. The preferred employees would be the ones with experiences, nice attitude and own initiative. The employees initial training will last one week as the employees should understand the company's vision and goals. Basic selling and communication skills would be trained. The shop owner will participate and explain the employees. External company would be hired for 1 day of training. Communication with client would be the topic trained. According to [www.jubela.cz](http://www.jubela.cz), the training company – usual price is about 4,000 CZK / 8 hours training / one person. Initial external training costs would be 24,000 CZK because there is 6 employees. The costs for initial employees training would be 5 days of 6 hours daily training. Gross wage for men hour was established at 137,5CZK / hour (with sales bonuses). These costs are calculated at 24.750 CZK for 6 workers in 5 days with by 6 hours at price of 137,5CZK / hour. Total costs for initial employees training 48.750 CZK.

### **Cost-benefit analysis**

Table 3 – Shop creation costs

<b>Regular costs</b>	<b>monthly costs (CZK)</b>	<b>yearly costs (CZK)</b>
Rent	320,000	3,840,000
Employees Salary	114,000	1,368,000
Advertisement	227,000	2,724,000
Cleaning Services (inside the store)	4,500	54,000
Insurance	5,000	60,000
Other costs( repairs etc..)	5,000	60,000
Accounting costs	3,000	36,000
Costs for wasting unsold products, cost of having more goods on stock	10,000	120,000
Electricity, water and heating	included in rent	included in rent
<b>Total costs</b>	<b>706,500</b>	<b>8,478,000</b>

Source: Created by author

Table 4 – Shop creation start-up costs

<b>Start up costs (for a single shop)</b>	<b>CZK</b>
All the equipment and accessories for new shop	300,000
Advertisement	400,000
Employees training	24,875
<b>Total costs</b>	<b>724,875</b>

Source: Created by author

These costs can be multiplied by 20 as there would be at least 20 retail shops in Czech Republic. However there is a little difference in costs in Brno, Prague and Jihlava. There are 3 shops planned in Prague which will be definitely more expensive. Two shops are planned in Brno and two in Ostrava which will be exactly reflecting the calculations and other 13 shops will be a little bit cheaper in costs. Therefore the calculation is as follows.

Total costs yearly for 1 shop are 8,478,000 CZK multiplied by two shops in Brno and two shops in Ostrava therefore 33,912,000 CZK, in case of start up costs it is 2,899,500 CZK. There are planned three shops in Prague – as it is very expensive city the calculation must be increased by 20%. This means start up costs of 2,609,550 CZK and yearly costs 29,095,200 CZK for all 3 shops. Finally there is planned 13 shops in Plzeň, Liberec, Olomouc, Ústí nad Labem, České Budějovice, Hradec Králové, Pardubice, Havířov, Zlín, Kladno, Most, Jihlava and Karlovy Vary. These locations are slightly cheaper compared to Brno and Ostrava so all costs are decreased by 10%. Therefore start up costs are 8,481,038 CZK and yearly costs 94,559,400 CZK. Details are shown in table below.

**Table 5** – Total costs for chain of shops

	Number of shops	Start up costs for one shop (CZK)	Start up costs for shops (CZK)	Yearly costs for one shop (CZK)	Yearly costs for shops (CZK)
Brno, Ostrava	4	724,875	2,899,500	8,478,000	33,912,000
Prague	3	869,850	2,609,550	10,173,600	30,520,800
Plzeň, Liberec, Olomouc, Ústí nad Labem, České Budějovice, Hradec Králové, Pardubice, Havířov, Zlín, Kladno, Most, Jihlava, Karlovy Vary	13	652,388	8,481,038	7,630,200	99,192,600
<b>Total</b>	<b>20</b>		<b>13,990,088</b>		<b>163,625,400</b>

Source: Created by author

In case of changing the distribution channel to chain of 20 shops owned by LR Health & Beauty Systems, s. r. o. there would be first year total costs of 177,615,488 CZK (rounded to 176,616,000 CZK). Under ceteris paribus the prices of the products remain the same. Therefore 176,616,000 CZK must be covered from 59,8% that is now used for distribution channel. Therefore there would have to be volume of sales for 295,344,481 CZK only in order to cover the costs for the shops. Average price of LR Health & Beauty Systems, s. r. o.'s product is 700 CZK. In the shops there must be sale of 421,921 products in Czech republic to cover the costs. Average monthly sale per one shop needs to be 1758 products per month and 58 products per day in order to cover only the costs for chain of shops and its associated costs. In the calculations is not covered increasing costs for legal and marketing employees that would be necessary.

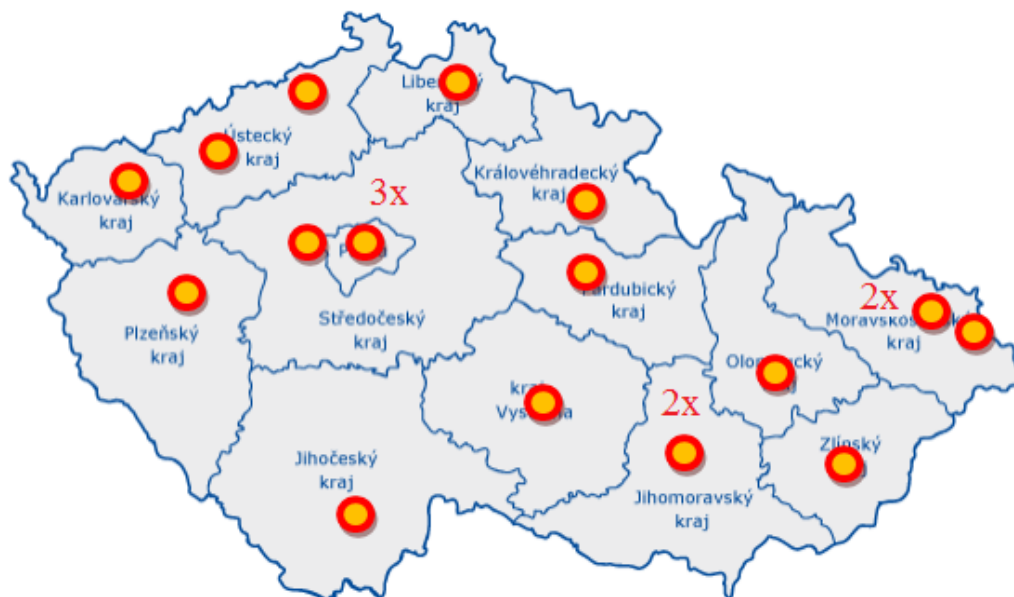
However today's number of sales is 720,000,000 CZK. To reach the same volume of sales it would mean selling 1,028,572 products via chain of 20 shops. Average monthly sale per one shop would must be 4,286 products and daily average sale per shop 143 products per shop every single day.



#### 5.5.4.1 Shops location

In case of establishing chain of shops or franchises the whole process must be perfectly planned. Number and distribution of the shops is one of the key factors. The main factor for distribution of shops is servability and accessibility for customers. Therefore the largest cities in Czech Republic must be covered by network of shops. Therefore all main regional cities have at least one shop (as seen on the map and table below). In case of Prague market there is necessity of at least 3 shops, Brno needs 2 shops minimum and Ostrava the same as Brno. By distributing the shops according to accessibility and servability is achieved the fact that 2,757,576 inhabitants of these cities can reach the goods. It is not possible only for the city citizens to reach the shop. The people from surrounding smaller cities and villages can come to the city and buy products. By this distribution there is not only 2,757,576 potential customers however the number can reach 4,000,000 potential customers. This is very high number and the rest of possible customers could be served by mail. But how would the rest of potential customers find out about the company and its products? Today it is done by LR partners. Hard accessibility of some remote regions might cause decrease in sales of products.

**Figure 20:** Map of potential shops in Czech Republic



Source: EU2009.cz: Regiony ČR, <http://www.eu2009.cz>, edited by author

**Table 6** – Table of shops location

<b>Name of the city</b>	<b>Number of inhabitants</b>	<b>Number of shops</b>
Praha	1,257,158	3
Brno	371,371	2
Ostrava	303,609	2
Plzeň	168,808	1
Liberec	101,865	1
Olomouc	100,233	1
Ústí nad Labem	95,464	1
České Budějovice	94,754	1
Hradec Králové	94,318	1
Pardubice	90,401	1
Havířov	82,022	1
Zlín	75,469	1
Kladno	70,665	1
Most	67,466	1
Jihlava	51,154	1
Karlovy Vary	51,115	1
<b>Total</b>	<b>2,757,576</b>	<b>20</b>

Source: Czech statistical office, <http://www.czso.cz/>, edited by author

## 6 Discussion

Aim of the company LR Health & Beauty Systems, s. r. o. is to maximise profit and increase market share. This can be done by various economic tools – decreasing price, improving product, etc. In this paper analyses have been done in order to evaluate and set other distribution channels. Analysed distribution channels are: selling the goods via existing chain of shops, selling the products via e-shop, franchising and establishing chain of 20 shops over the Czech Republic.

Business alternative of selling products via existing chain of shops might seem rather efficient and „easy“ from the first sight. Advantage of this distribution channel costs decrease as the logistics, rent and workforce is not paid by company's money. LR Health & Beauty Systems, s. r. o. is in this case only a supplier and does not bear so high risk. On the other hand the profits are splitted and as always the one who bears higher risk gets higher profit. Firstly, the company has over 1,000 products in its portfolio and such a large portfolio couldn't be fitted into some other shop with wide offer of other products. Secondly the company could be damaged by lower level services for clients as it would be nearly impossible for shop assistants to learn sufficiently about this many products and its effects..

Other analysed distribution channel is selling the products on the internet. This way of distributing goods and services is on rise because it decreases the costs for the seller. Therefore the can decrease the price for consumers. The company LR Health & Beauty Systems, s. r. o. doesn't sell any of their products on the internet and never did. It is completely against the philosophy of the company because at LR Health & Beauty Systems, s. r. o. there is on the first place quality of service for the customers, not the lowest price. The contact and relationship with a client is essential for this company from ever since. This is the key factor for LR Health & Beauty Systems, s. r. o.'s success. Moreover in questionnaire 75% of current clients declined the possibility of buying the products on the internet. Based on general analysis and marketing survey distribution system via e-shop is not effective way for LR Health & Beauty Systems, s. r. o. at the moment.

Franchising is very interesting way of distribution in the sense of decreasing costs. Total costs for first year for one franchising shops are calculated at 3,520,000 CZK and major part of these costs is advertising campaign. If there was high

number of franchisees then the costs per shop would be decreasing. In franchising franchiser gives know-how (for financial rewards) and way of doing business to franchisee who has good knowledge of local market and can apply it better. Moreover franchiser doesn't bear big risk as in case of selling the products by owned shops and therefore the franchisee keeps large part of profits. LR Health & Beauty Systems, s. r. o. is not afraid of carrying risks in order to reach its goals. Franchising is interesting if a company wants to cover large market fast, however the profits for mother company are not satisfying for LR Health & Beauty Systems, s. r. o. at this moment.

Last but not least distribution channel is selling in chain of 20 shops over Czech Republic. Generally much more goods is sold in shops than in direct selling. However the customers attitude to creation of shops is strongly negative based on the data from marketing survey. There is high possibility that new customers would find out about the brand. On the other hand customers located further from closest branch will probably switch to different brand. Interesting for the customers would be immediate shopping. No ordering the goods however taking the product home in the minute of shopping. The customers demand the products not only because of the quality and uniqueness of the brand. Mainly it is relationship between LR partner and customer. This can never be done via chains of shops in such an extent. The clients who buy products from LR Health & Beauty Systems, s. r. o. receive not only piece of goods but mainly caring and piece of advice at any time from LR partner.

Based on analyses and my long term experience with this brand, quality and product this volume of sales couldn't be made via chain of shops. To cover only the costs for chain of 20 shops average monthly sale per one shop would have to be 1758 products. Moreover to achieve the same level of revenues as the company performs today average monthly sale per one shop would have to be 4286 products - every day average sale of 143 products in all 20 shop. These high costs and hardly possible sales would have to be done in order just to get to the same volume of sales as it already is today in LR Health & Beauty Systems, s. r. o. without any complications. The aim of the company is to maximise profit and increase market share and both of these targets would be very hardly achievable.

## 7 Conclusion

Generally by changing the distribution channel, the company would have to change a much of its business philosophy, workers and partners. Moreover it would set the company to different field of activity. This would bring different legal environment and mainly marketing environment. New so far unknown competitors would occur. Different customers like to use different distribution channels therefore the company would have to persuade new customers who like to use the other distribution channel to buy the company's products. In between some of the company's current customers might lose interest and could seek different supplier using the same distribution channel. Moreover, costs of changing the distribution channel would be high in administrative, logistics, training of employees, etc.

Different distribution channels are analyzed in this paper – selling the products via existing chain of shops, selling the products via e-shop, franchising, chain of shops creation and compared to current distribution channel – direct selling.

Selling company's products in existing external chain of shops would lead to decrease of costs. On the other hand the company uniqueness and brand might be damaged. The products would lose its uniqueness by being put onto shelves next to all other products. However for the company is main goal to increase market share and maximise profit. Based on the analysis the profit might be stable or even increasing in the short-run however in the long-run the customers wouldn't be motivated by such customer-seller bond and it would probably lead to decrease of sales. After analyzing the company LR Health & Beauty Systems, s. r. o., it is clear that using external chain of shops distribution model is not efficient for this company.

Selling via e-shop would definitely lead to decrease of costs however a customer must be well advised in order to use the product precisely (especially health products) and this would be hardly achievable. The customers showed their preferences in marketing survey and in major declined possibility of shopping the LR Health & Beauty Systems's products on the internet. Therefore selling on the internet is not an efficient variant of distribution channel at the moment.

Franchising is very interesting way of distribution for the producer as the franchisee bears a lot of risk. This is clearly an advantage for supplying company. On the other hand the profits are divided between franchisor and franchisee. This would set the company more or less into position of supplier than seller. This would probably lead in case of LR Health & Beauty Systems, s. r. o. to decrease of profits.

The last but not least analyzed distribution channel is creation of chain of shops. The necessary customer-advising attitude might be fulfilled if the employees were trained efficiently. Even the company name might not be damaged as the shops would be under direct influence by the company. This distribution model brings a lot of new costs however a lot of new profits as new customers might be attracted. The calculated number of sales would have to be far too high to achieve it generally in all shops in order to get to the same volume of sales. Moreover the results of questionnaire most of the customers of LR Health & Beauty Systems, s. r. o. wouldn't appreciate creation of shops. This means that even changing the distribution channel from direct selling to creation of own chain of shops wouldn't be efficient from economical point of view.

Based on all analyses the current distribution model of subsidiary company LR Health & Beauty Systems, s. r. o. and mother company LR Health & Beauty Systems GmbH is more effective than other analyzed distribution channels ( selling the goods via existing chain of shops, selling the products via e-shop, franchising and establishing chain shops). Therefore the recommendation is to keep the used distribution channel and focus on improving all economical and social factors connected to the distribution.

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## 9 Appendix

### Questionnaire:

#### 1. Age:

- 0 – 18 years
- 18 – 30 years
- 31 – 39 years
- 40 - 55 years
- 56 and more

#### 2. Sex:

- Male
- Female

#### 3. The highest achieved education:

- none education
- elementary education
- secondary education
- secondary with GCSE education
- university education

#### 4. Do you monitor other health or beauty brands?

- Yes, I regularly monitor other brands
- No, I get information from LR consultant
- Sometimes I get some information (not on purpose)

#### 5. How many products do you use?

- none
- one – two
- three – five

- six and more

6. Why do you choose LR Health & Beauty Systems products?

- good price
- good quality
- good service
- different reason:.....

7. Would you appreciate creation of LR Health & Beauty Systems shop(s)?

- Yes
- No
- Maybe

8. Would you appreciate possibility of buying LR Health & Beauty Systems products on the internet?

- Yes
- No
- Maybe

9. Would you recommend the products to a friend?

- Yes
- No
- Don't know

10. How would you like to be informed about news of LR Health & Beauty Systems?

- by e-mail
- by phone call
- by post
- by LR Health & Beauty Systems consultant

**Thank you for your time!**