

## INVESTMENT DECISIONS IN DISTRIBUTION FOR FOOD PRODUCTS COMPANIES

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#### Abstract

*Efficient planning and management of investments have become not only an important problem but also a complicated problem in the dynamically changing environment.*

*The goal of this article is to develop a theoretical basis for creating a decision support system for distribution for food products companies. To achieve the goal, the following problems have to be solved: determination of the characteristics of merchandise distribution companies, determination of the adequate methods, and identification of the recommended values of dynamic indicators for the determination the eligibility of the investments.*

*Keywords: investment decision, economic indicators, present value, future value, distribution companies*

*Jel classification: D39, M19*

### 1. Characterisc of distribution

The term *distribution*, in Patriche's vision<sup>164</sup>, designates the complex of means and operations ensuring the placement at the users' or final consumers' disposal of goods and services provided by manufacturing enterprises. Or, in other words, distribution represents the process by which the goods and services are placed at intermediate or final consumers' disposal, providing them with the facilities of location, time, size, etc.

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Clients appreciate the immediate availability of the merchandise, being ready to pay an additional amount for this facility. As a result of this decision, the distributor now supplies in a profitable way the market at the national level, whereas manufacturers benefit from a uniform demand. The distributors that feel that they are in a partnership relation with their suppliers can influence their clients to purchase a certain product. Briefly, distributors can achieve the differentiation of the product.

The means and operations designated by the term *distribution* are classified into two big categories that can be designated by the notions *commercial distribution and physical distribution*. The commercial distribution consists in the transfer of the ownership title over the product from the manufacturer to the consumer. That distribution can be ensured by distribution agents. They can be individual, such as the sales agents of an enterprise, or wholesale enterprises, companies whose object of activity are mail order selling or retail trade etc. Physical distribution, in its turn, consists in placing from the material point of view the goods and services at consumers' disposal, with the help of the means of transport and stocking. The physical distribution can also be found in the specialized literature as commercial logistics.

In a society based on knowledge, distribution exceeds the limits of a mere transmission of merchandise, adding or associating to it a constantly-increasing range of services, as well as an active influence of production, based on the detailed knowledge of the consumers<sup>166</sup>.

Distribution is meant to regularize the circulation of goods and services between production and consumption and satisfy consumers' needs, providing them with a series of services, giving them the possibility to choose from a wide range the goods and services that better correspond to their needs and exigencies etc.

Among the main function of the distribution, the specialized literature mentions the following:

- change of the ownership over the product, namely the performance of the successive transfer of the ownership right from the manufacturer to the consumer via sale-purchase agreements;
- displacement of the products from the manufacturer to the consumer through activities of transport, stocking, conditioning, handling, dismounting or assembling, packaging, exposure for sale, sale etc.;
- information, consultancy and provision of after-sale servicing in order to ensure a good information of the clients about the possibilities to satisfy various needs, facilitate the operations of choice of the necessary products and assistance in the process of maintenance and use of the different purchased goods<sup>167</sup>;

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164 Patriche D., *Economie Comercială*, Ed. Institutul National Virgil Madgearu, București, 1993, p. 35.

165 Dayan A., *Manuel de la distribution*, Les Editions d'Organisation, Paris, 1987, p.23.

166 Gnetta J., *A chaque type de client, un marché spécialisé*, Rev. "Le nouvel économiste" nr.932/1999, Franța.

- financing of commercial operations, a function that considers the existence of cases in which distribution agents finance manufacturing enterprises in the product purchase and stocking process in intervals in which the merchandise is produced and not sold to the client immediately.

The enumerated functions point out the fact that distribution plays a multiple and beneficial role for both the manufacturer and the consumer.

With regard to the manufacturer, distribution operates a regularization of the manufacturing activity, allowing the manufacturer to break down production all over the management year by advance orders and stocking, operations that annihilate the effects of the seasonal or circumstantial oscillations of the demand, the distribution participating in the financial efforts of the manufacturers, paying for the goods stocked without having the certainty of their sale. By its functions, distribution also allows the manufacturer to orient its production and send its products everywhere, by the participation in the organization and performance of promotional actions meant to ensure a better sale of its products or services.

With regard to the consumer, distribution also plays an essential role. It places at the consumer's disposal, wherever it is and whenever it wants, the necessary goods in the requested quantities. By such facilities, distribution spares the consumer of long trips, efforts to perform big purchases and immobilizations of amounts that, made available this way, can be used for other purposes.

Contemporary economy, by the complexity of the phenomena it generates, makes distribution methods evolve constantly. In such a context, new forms of wholesale and retail sale as well as new retail distribution systems appear<sup>168</sup>.

Manufacturing companies, from the perspective of the distribution companies, are at both ends of the chain, as both receiver of raw materials and components and product offerors. The thinking style of commerce business is based on the improvement of the relation between sales and purchases and as the sum between efficacy and efficiency by a constant reconciliation between standardization (avoidance of the renunciation to a commercialized product) and flexibility (introduction of a new product in sales) and by the monitoring of the performance indicators for cost/price, quality and delivery time. Productivity is extremely important when we are talking about market share and even competitiveness level. The factors influencing the productivity level in distribution companies are the following: supplier management and 'best practices' conception, company losses, competition monitoring and constant improvement of the client relation. In synthesis, the distribution business process is as follows: suppliers, logistics, storing, sale, clients.

## 2. Investment decisions

Investments have a determining role in the development of a business, as any mistake in this domain endangers the life of the organization, investments representing in fact a certain expense for a future full of uncertainty<sup>169</sup>. Generally speaking, *the notion investment comprises all expenses or funds an allocation from which future income is expected*. The investment process supposes the allocation at a given moment of a quantity of currency to a direction that may produce income in several successive periods of time.

In their restricted meaning, *investments represent expenses performed to obtained fixed assets, namely for the construction, reconstruction, expansion, modernization and purchase of fixed assets such as machines, equipment, means of transport, etc.* By the investment process in restricted meaning, currency is turned into fixed assets, we are therefore talking about the allocation of funds for activities of replacement or expansion of working tools.

The investment decision must be based on complex and exact information referring to the necessity, opportunity, volume of the expenses and financial resources, fund receipts and disbursements during the whole period of operation of the fixed assets, provision of profitability and liquidity, recovery of invested capitals, duration of execution and operation of the investments, etc.

The investment decision corresponds to the top management of the enterprise, as it engages in general wide-span actions involving major consumption of capital.

When a project is started, the management team naturally becomes aware in a certain extent of the probabilities not to achieve the proposed objective. It is therefore necessary to know the risk and uncertainty and select the action measures meant to prevent or diminish those risk factors.

At the same time, successful companies are periodically performing critical reassessments of the allocation of the resources in investments in order to see whether the current performances and estimations for the business products, services or segments are still in the same line with the organization's global strategic position. Should an attentive analysis reveal economic results or estimations about a certain market or activity below expectations, then the disinvestment, seen as diametrically opposed to investment, becomes a decision-making option. The activities with weak result are responsible for the destruction of the business value. The sale of the assets afferent to these activities or the sale of the operational units in block, using the principle of the continuation of the activity, allows

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167 Montgomery St. L. : Profitable Pricing Strategies, Mc Graw-Hill Book Company, New York, 1988, p. 151-160.

168 Kotler Ph., Managementul marketingului, Ed. Teora, București, 1997, p. 684.

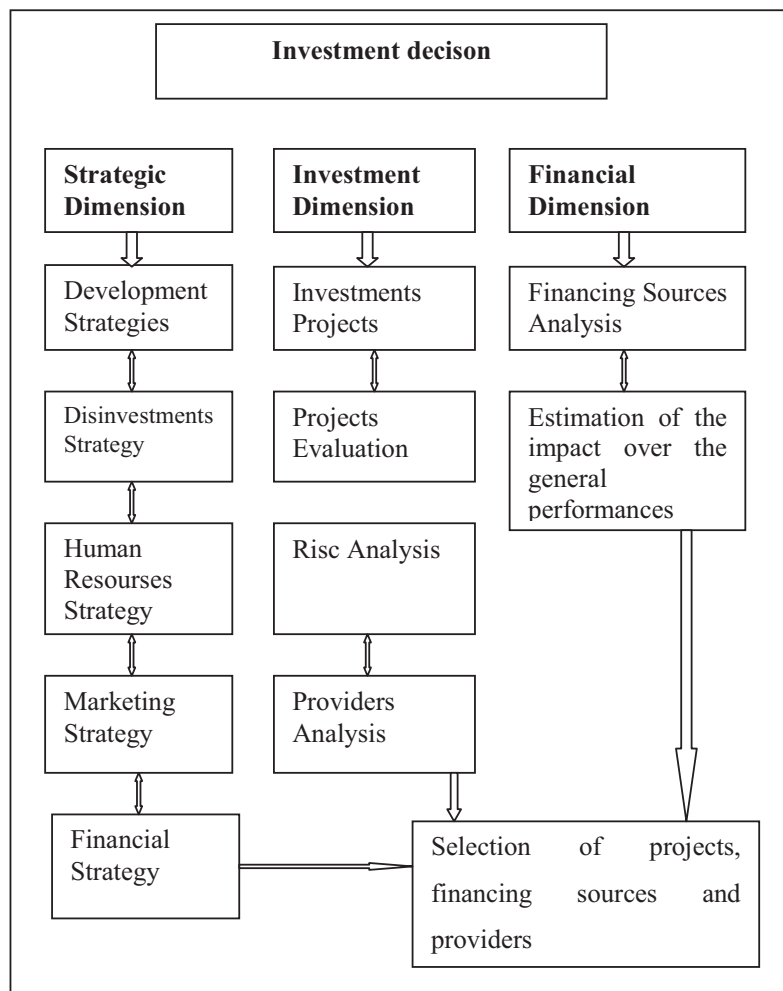
169 Vasilescu I, "Pregătirea, Evaluarea și Auditul Proiectelor Economice", Eficon Press, 2006, pg. 89.

the recovery of the invested funds and their reallocation for other activities in a more advantageous way, by making new investments, reducing indebtedness or redemption of own shares from the market. Also, the sale of fixed assets and their replacement by new ones create by their sale, financing sources for the new acquisitions.

The references necessary for the selection of the investments or disinvestments are general economic performance criteria. They are based on cash flows, measuring the influences of the option between the fund invested at present and the cash flows expected in the future from operational activities and residual values of the investments performed. The financial measure tools based on cash flows are the following: the net present value - VAN, the internal rate of return - RIR, the profitability index - PI.

On the other hand, the usual references used to measure the existing investments are generally based on the data and relations of the accounting of the companies. Indicators such as profitability of the invested capital, profitability of the net assets and profitability of the operation assets link the data existing in the accounting balance and the ones of the profit and loss statement.

According to Cocriș and Ișan<sup>170</sup>, no matter the decision-making situation (certainty, uncertainty or risk), the investment decision has three dimensions: the strategic dimension, investment dimension and financial dimension.



**Table 1 – Dimensions of the investment decision**

Investments of the food distribution companies represent acquisitions (or constructions under own contracting) of real estate properties, mobile assets, commercial investments and human resources investments.

The investments in mobile assets of the merchandise distribution companies consisted especially in means of transport and stock.

Investments in human resources of merchandise distribution companies basically represent the key of success of these companies, the distribution activity implying a direct contact between people. No matter how good the client

170 Cocriș V., Ișan V., „Economia Afacerilor”, Editura Graphix, Iași., 1995, pg. 114-118.

service strategy, people will be the ones to apply it, and client' perception over the provided services will lead to the failure or success of the organization. The penetration of the strategic human resources management concept as well as the models practiced by international companies require a sustained training programme, career development, motivation, delegation, performance assessment and employee satisfaction measurement. Investments in the human capital give value to an organization to the same extent as any type of investment. Romănu and Vasilescu<sup>171</sup> believe that all investments are defined by four characteristics: the individualized concrete content of resources, the time factor, the efficiency or future effect of the use of the resources at present and the investment risk.

In the restricted meaning, in the studied situation of merchandise distribution investments represent expenses made in order to obtain fixed assets, namely for the construction, reconstruction, expansion, refurbishment and purchase of fixed assets such as deposits, means of transport for sales agents, means of transport for merchandise, PCs and online communication systems, etc. Other expenses are assimilated to investments, such as: expenses referring to design works, training of the staff necessary for objectives under construction, etc. By the investment process in its restricted meaning, currency is turned into fixed assets, so that we witness the allocation of funds for activities or replacement or expansion of working tools.

For the manager of the organization, investment is first of all a decision to immobilize a capital in order to obtain good profitability. His/her main role is to find the financing sources necessary for the investment assess and obtain an adequate profitability. From the financial point of view, an investment characterizes by very high expenses by fund receipts during all its operation intervals.

### **3. Dynamic indicators used in estimating the economic efficiency of the investments in distribution for food products companies**

Construction of the alternative investments' models in a distribution companies is based on determination of input-output indicators and relations. In analysis of alternative investments in an enterprise we could get answers on the following questions:

- What investment alternative in enterprise is the most profitable one?
- Determination of choice between alternative investment possibilities.

In the process of finding out the answers on above-mentioned or similar questions, it is necessary to define the investment goal. If the leading principal is profitability, in the case when we have at disposal mutually exclusive investment projects, the investor would tend to invest available financial resources into economically most profitable solution. In the process of selection between possible investment project alternatives, the decision will be made in favour of the alternative with highest profitability degree, with greatest amount of profit in an enterprise. It is necessary to emphasize that it is started from preposition that management team makes choice between two possible investment alternatives economically justified in an absolute sense with given calculative interest rate. That is why the solving of this problem is in making choice of those investment projects which could be more profitable for the investor.

If management team has at disposal amount of financial resources sufficient for implementation of only one of possible two alternative investments, then profitability level of chosen investment alternative should not be lower than minimal profitability level investor would like to achieve in the process of investment into enterprise. In that case the investor limits itself into the project that promises the highest level of economic effectiveness. In that way there have been adjusted amounts of available financial resources with investment possibilities in an enterprise.

The concept "time value of money"<sup>172</sup> is used in the evaluation of investments projects expected to provide benefits over a number of years. Money can be thought of a having a time value. In others words, an amount of money received today is worth more than the same Ron amount if it were received a year from now.

Because of the fact that the processes and the phenomena from the investment field are influenced by the implications of the time factor, it is necessary to value dynamically the parameters of the investment projects (the investment value, the project incomes and costs, the profit or the net cash flow etc.).

The dynamic valuation of the effort and effect indicators within the analysis of the economic efficiency provided by the investment projects has a significant relevance, when the value indicators defining the investment activity involve an unfolding, an evolution in time and consists in recalculation of the investment parameters, their presentation depending on the reference chosen moment, an operation that requires the use of the up-dating procedures. So, the up-dating is a specific method for the dynamic valuation of the investments economic efficiency, giving the possibility to calculate certain adequate dynamic indicators(engaged capital/ up-dated total costs, the Payback Period - PP, the net present value - VAN, the profitability index - PI, the internal rate of return - RIR) that allow to express and estimate the economic efficiency of the investments.

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171 Romănu I., Vasilescu I. (coord.), "Managementul investițiilor", Ed. Mărgăritar, București, 1997, pg.15.

172 Moyer Charles, J.McGuigan, Ramesh P. Rao, Fundamentals of Contemporary Financial Management, Second Editions, Ed.Thomson, Mason, USA, 2007, pg.161.

## Conclusion

In distribution companies, it is aimed to minimize the capital commitment at a given level of the storage capacity, total incomes and total economic advantages.

According to the criterion VAN, must be accepted the projects and the project variants for which  $VAN > 0$ . If more variants of the investments projects are compared, then is preferable the project providing a minimum payback period. A project with  $VAN < 0$  has to be rejected because its rentability will be smaller than the updating rate.

An independent investment project must be accepted only if  $PI > 1$  and has to be rejected if  $PI < 1$ . The project having  $PI = 1$  (same as when  $VAN = 0$ ) will provide the recovering of the investment expenditure only, without generating some profit. The more  $PI$  is the more profitable are the projects.

When we compare alternatives of investment projects or project variants, characterized through  $VAN$  close values the priority is given to the project (variant) having a maxim RIR.

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