

A Study on Logistical System and Operational Models of Franchise Store Retailing in China

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Franchise store retailing is taking on ever greater roles in business and commerce in China. The diverse product range, small-batch order, high frequency and time-specific requirements inherent in retail logistics make it the most complicated of all categories of logistics. In franchise store retailing, expanding business scales make trans-regional development a trend. Without a well-functioning logistic system, the standardized delivery of products would be held back, impacting trans-regional development strategy and operational costs. Therefore, the efficiency of franchise store retailing largely depends on logistical efficiency. The integrated and streamlined management of franchise stores depends in large measure on their logistical centers. As such, logistical centers constitute the key link and bears on core competitiveness in franchise store retailing. This thesis begins with an analysis of the current developments and four basic logistical models of franchise store retailing in China, proceeds to summarize developmental trends as well as focal issues and proposes an efficiency enhancing plan.

Key Words : Franchise Store Retailing; Logistics Operational Model; Third Party Logistics; Self-support Logistics

I. Introduction

Since franchise store retailing emerged in the 1990s, the Chinese retail sector has achieved break-neck development. Within a period of twenty years, the scale advantage of franchise store retailing has enabled it to span across such retail sectors as pharmacy,

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books, audio/visual products, building materials and furniture, etc. In terms of business models, franchise store retailing has covered various retail forms: department stores, convenience stores, specialized stores and warehouse stores. Franchise store retailing is a revolutionary change in China's retail sector. Its development is both a break from and a challenge to the traditional retail models in China.

Franchise store retailing, based on a chain system and wide distribution of outlets, cuts down on purchasing prices and increases profit margins with a central procurement system; its multi-purpose, streamlined logistic centers serve to reduce inventory and reap profit from logistics. By feeding market information to manufacturers, self-owned OEM brands can be developed, with a slice of manufacturing profit as the reward. Franchise store retailing is an ideal business model that integrates the flows of commerce, logistics and information in a mutually complementary way (Xu, 2011). A multi-year survey released by China Franchise store Association in 2010 shows that the retail sector in China has been on the path of scale expansion; and franchise store retailing in China is transitioning from high-speed development to a stage featuring steady growth. The Industry Annals 2010 released by China Franchise store Association shows that the top100 retailers achieved a total sales volume of 1.66trillion RMB, representing a year-on-year increase of 21.2% and accounting for 2.8percent of total retail sales. Suning Appliances Group topped the list with156.2billion in retail sales, while GOME, Bailian, Dashang, Huarun ranked 2nd to 5th, with sales volume respectively at154.9, 103.7,86.2 and 71.8billion RMB. The last retailer on the top100 list had a sales volume of 2.2 billion, increasing 37% over the last year.

With the ongoing development of Franchise store retailing in China, the importance of distribution and logistics has come to the fore for retailers. Many large and medium franchise store companies have set up self-support distribution centers to deal with multi-assortment and small-batch logistics. According to the latest statistics from the China Franchise store Association, 80% of the top 100 retailers have self-support logistics center, with an average distribution center of 20,000 square meters. In contrast, only 30-60% of small-to-medium retailers' operation is up to the standard of centralized purchasing and integrated distribution. The modernization of logistical management is intended to deliver expected logistical service at a minimal cost, or to deliver logistical services of the highest-possible quality with a fixed logistical budget. Although the current logistical management models have played a widely recognized role in enhancing retailers' management efficiency and lower costs, many retailers still haven't come to terms with modern logistical philosophies, resulting in low logistical operation efficiency relating to a

traditional storage operation mode. In the process of trans-regional development process in particular, many companies fail on account of poor logistics and supply chain management. By detailing and analyzing the four primary logistical operation models employed by franchise store retailers, this thesis sets out to identify the problems in the logistical systems of franchise store retailers, provide rational improvement suggestions and put forth logistics optimization plans for Chinese franchise store retailers.

II. Major Logistical Operation Models Used by Franchise Store Retailers

Modern logistics has long been a highly emphasized aspect in developed countries, with a large number of scholars having devoted time and expenses to in-depth research and a wide range of theories having been formulated. Meanwhile, colleges and research institutes abroad have set up logistics disciplines and training centers, boosting the development of logistics with a non-stop infusion of high-level logistics expert. In China however, the value of logistics as a new industry has not been keenly realized. And for a long time, logistics in China remained at an embryonic stage. Logistics have undergone tremendous progress with deepened understanding and focused attention in the academia. In late 1990s, a spurt of intensive researches surfaced, along with expanding research perimeters, increasing number of researchers and research results, including *A Study on Logistics and Distribution Centers* (Zhou & Guang, 2011), *Urgent Logistics Problems Awaiting Solutions* (Tao & Zhu, 2005), *Supply Chain Problems* (Li, 2009), *Research on Third Party Logistics* (Liu, 2005; Wang, 2010; Shi, 2010), *Logistical Problems under E-commerce Environment* (Sun et al., 2006; Fu, 2008). According to the type of providers of logistical services, the logistical operational models in China's franchise store retailing can be divided into four types:

First of all, there is the retailer self-support logistics & distribution model, in which franchise store retailers set up logistical centers with their own funding. Some large-scale Chinese retailers have their own logistical centers because a large proportion of them were evolved from companies that dealt in foodstuffs, produce, grain and cereal along with accompanying sales networks. These companies have the sites, equipments and personnel necessary for logistical operations. On the other hand, although the cooperation with retailers and logistical companies yield certain advantages, cooperation is fraught with risks

due to differences in location, culture, law, values and management methods. Such management problems are likely to arise as outsourcing decision risks, outsourcing contract irregularities, outsourcing price mark-ups, low-quality services and poor client management capability. Meanwhile, a virtual organizational structure weakens the management system and increases uncertainties, which is likely to cause risks in cooperation (Wang & Liu, 2002). Such uncertainties are likely to stem from lack of consensus, effective communication and trust. These potential risks are prone to compromise expected gains from cooperation such as lowered costs, reduced response time and added market value, etc.

According to the statistics from China Franchise store Association, 80 percent of retailers on the top 100 domestic retailer list in 2010 had their own logistical systems, with an average logistics floor space of 9693 square meters. Self-support logistics centers are a crucial component of franchise store retailers. They are flexible, geared toward the specific needs of store outlets and are suitable for large-scale retailers. For small-to-medium retailers, setting up self-support logistics & distribution centers would bring huge construction and operation costs, resulting in corporate resource waste. Therefore, logistics are still potential pitfalls for retailers. One survey shows that out-of-stock rate of domestic retailers is around 10 percent, causing annual losses of 83 billion. Stock-outs induce a range of buying behavior on customers' part: 48% of them would buy alternatives; 15% would not buy again; 31% would go to another store. The rate of change-store buying among customers is 37%.

The second model is the third party logistics and distribution model, in which franchise store retailers outsource part or all of logistical services to specialized logistical companies (Wang & Liu, 2002). Under this mode, logistics & distribution centers are large and have full-range delivery capacities. Its advantage lies in specialized and high-quality service, low logistical costs, along with advanced management and equipments. Its disadvantage is that with profit as the incentive, logistical centers will divide clients into major clients and average clients with an 80/20 ratio and provide them with differentiated logistical services.

In recent years, some international retailers have gradually embarked on the journey of focusing on core business and specialized development, while outsourcing logistics to specialized logistical service companies. This trend is more and more obvious. In Japan, around 30 percent of franchise stores rely on specialized logistics companies, including 711 convenience stores and Ito Yokado. In Japan, individually-owned retail stores account for 90 percent of all stores. A competitive market compels these stores to rely on third-party logistics. In the retail sector in China, third-party distribution is not prevalent, but some

supermarket chains have made beneficial trial runs of third party distribution. As early as 2002, Beijing Wumei and Huang Tianbai signed a contract delegating the latter with the responsibility of logistic services. Wumei has more than 300 convenience stores and convenience supermarkets in Beijing, while Huang Tianbai is a specialized third-party logistics company. As an initial step, the cooperation between Wumei and Huang Tianbai, with the latter charged with providing logistical services to 200 plus Wumei stores, is poised to challenge the dominance of the self-support mode of logistics.

From the perspective of developmental strategy, apart from gaining specialized services, technologies and a cost advantage, franchise store retailers get strategic benefits as well(Luo, 2004). First of all, their focus can be laid on development core business. The core business of a retailer is to choose new sites for outlets, expand sales networks, do sales promotions, decide on product layout and purchasing. By outsourcing logistics, franchise store retailers can focus limited resources to their core business. Second, by drawing on third-party logistics, franchise store retailers can reduce investment and lower risks. The infrastructure, equipments and IT systems needed for modern logistics require huge investments. Because of uncertainties and complexities, tremendous investment risks are involved. Therefore, with the rise and maturing of specialized logistical companies, outsourcing product distribution or all logistical work to logistical companies would be a choice for franchise store retailers. Some business departments such as transport and storage management as part of the logistics sector have been separated from the main parent company and specialized in logistical services. Some logistical companies have begun providing services geared towards franchise store retailers.

The third model is supplier distribution mode. Suppliers are directly responsible for the distribution of their products. Individual franchise stores send orders to suppliers, who then send the needed products to outlets within a prescribed time limit. This is a system where the retailers' suppliers establish a self-owned distribution & logistical system to service franchise stores' needs. Many of China's manufacturing giants have distribution systems of their own; and by extending their distribution channels to franchise stores, suppliers can directly send products to outlets, take Haier Logistics & Distribution Center and Daxing Appliance for example. This supplier distribution mode's advantage lies in greatly reduced franchise store operational costs and complexity. Therefore, small-to-medium franchise store retailers generally rely on suppliers for distribution. However, under this logistical system, logistical service is under the constraints of suppliers' logistical limits and is dependent on effective information sharing between the stores and suppliers. According to China

Warehousing Association's 2004 survey on logistics in China, 75 percent of Chinese businesses' logistical needs are serviced by suppliers. Manufacturing companies arrange logistical services on the basis of product characteristics, distance, freight capacity and seasonal differences.

The fourth model is joint distribution mode. Joint distribution refers to several retailers pooling funds to set up jointly-owned distribution centers under joint management with the purpose of rationalizing overall logistics and providing uniform logistical services for all participants(Wang & Liu, 2002). Its advantages are twofold: First of all, by means of joint distribution for more than one retailers, vehicle utilization rate can be raised with lower costs and better services, so that logistical efficiency and logistical rationalization level can be raised; Secondly, social resources can be used in a mutually complementary way, leading to better utilization of resources. The drawback of the joint distribution mode lies in coordination and organization difficulties. Cargo owners have different requirements regarding time, location, safety and numbers for their freight. It is difficult to satisfy competing demands; there are additional difficulties in allocating benefits. Because the benefits for each retailer in joint distribution is hard to measure objectively, the fair and reasonable apportioning of services is hard; besides, some business secrets are prone to leaks in joint distribution. Some cargo owners are unwilling to participate because of concerns about business secrets.

III. The Current Franchise Store Retail Logistics System and Existing Problems

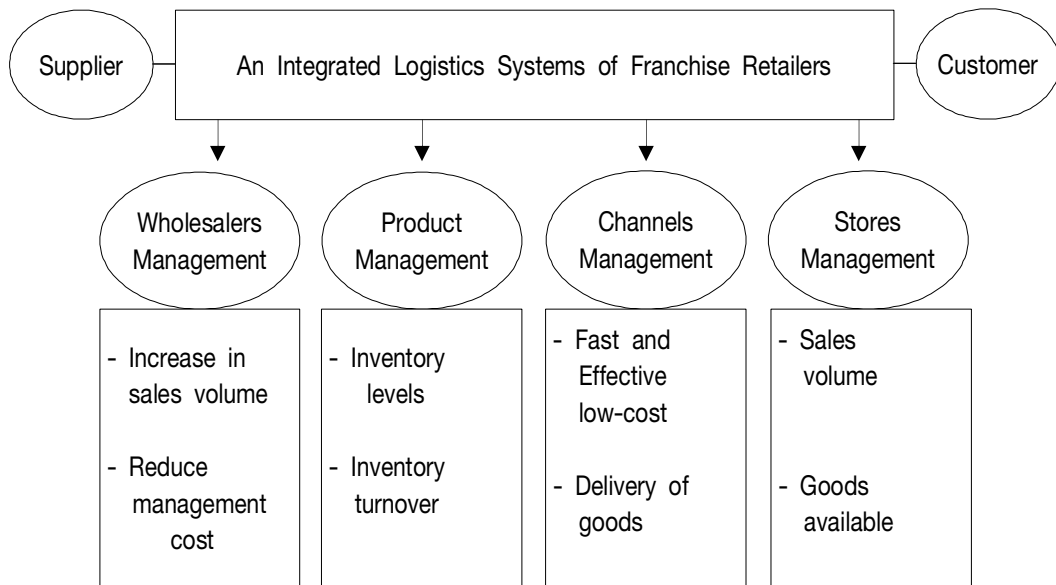
3.1. Franchise Store Retail Logistics System

Franchise retailing logistical system integrates inventory information bearing on purchasing decisions and the flow of goods with the best-possible logistical model. It comprises all the links in the process that delivers products to clients with minimum costs. Its sub-systems include distribution, inventory control, storage management, processing, refund management, etc(Zhang & Xiao, 2008). Its basic function is to deliver required products to sales platforms or customers with minimal operation costs.

With the product range expanding and sales channels for retailers diversifying, retailers

must cater to more diverse and multi-tiered consumer demands. In the buying-selling relation between manufacturing and retailing, retailers hold the upper hand. The retailing sector influences and guides manufacturing with its vast sales network, direct contact with consumer base, sales capacities, sales & consumer needs information processing capacities. Su & Zhu(2007) summarize the logistic system as follows in Chart 1. Today's franchise retailers can build a new kind of logistic system by integrating their main functions in the logistic system and integrating channel resources. Therefore it would be possible to deliver quality service to end consumers with minimal costs on the one hand and control sales channels with an edge over suppliers.

Figures 1 An Integrated Logistic System of Franchise Retailers



3.2. Problems of Chinese Retailers' Logistic Development

First of all, information flow in logistical operations is not smooth. Many of China's retailers are not standard equipped with EOS(Electronic Ordering System) and EDI (Electronic Data Interchange) in internal data collecting and external information sharing. Compared with modern automated logistics in foreign retailers, material consumption and logistic costs are exceedingly high(Wang, 2008).

It is reported that IT investment made by Chinese retailers accounts for less than 0.2%

of their retail sales, while the figure for international retailing giants stands mostly above 2%. Chinese logistic operators' IT investment takes up 2 percent of total capital, while the number for foreign companies averages 8-10 percent. The processing, analysis and mining of information are in the lacking, with corporate logistic information system underused. On the other hand, modern information technology and computer technology are widely in use in western retailers. In America, Europe and Japan, most retailers use POS, EOS, SCM, MIS and CMS information systems to enhance management level and efficiency.

Second, logistic operation scales are small with low standardized distribution efficiency. Most retailers in China have small logistic scales, with most of logistic centers below the entry-level requirements for scale economy. Statistics have shown that although on average China's retailers have 17 stores, but many retailers have only 3-4 stores. The biggest domestic retailers, Shanghai Hualian Supermarket, pales against Wal-Mart's 5085-store global layout. Take Beijing for example, most retailers have their own vehicles and storage space, but the actual load rate of self-owned vehicles stands only at 25 percent. Jingdong Shangcheng, famous for establish 3C e-business model and reaching 4 billion and 10 billion in sales through 2009 and 2010, faces low logistic efficiency in the process of expanding business scales. Its logistic processing capacity lags behind the growth in orders, forcing it to announce delayed delivery for orders.

Domestic experts on logistics point out that most vehicles for logistic purposes are safety-reliable minivans that lack specialized loading and unloading equipments. In loading and transport processes, a lot of logistical costs are incurred. Most of minivans have less than a third of the inner space of specialized vehicles, falling far short of logistic requirements. With low efficiency and high energy consumption, they are a drag on the logistic risks and costs for retailers.

Third, inadequate infrastructure and low automation rate are constraining factors. The annual report released by Horizon Research Consultancy Group shows that, of the 304 commercial enterprises that engages in logistics, 20% have a standard delivery rate of 40 percent, 67% have a rate between 50-70%; fewer than 15% have a standard delivery rate of 79-90%. Most logistic centers of Chinese enterprises are poorly equipped, with no specialized separating devices or electronic scanners, and rely heavily on manual labor (Huang, 2009). Meanwhile, logistic centers abroad mostly have been mechanized and automated. Tiered warehouse facilities in America mostly have specialized communication networks, while state-of-the-art high-end logistic technologies, like computer-operated robots and robotic arms, high-speed separating devices and special-use vehicles, have been in use

in Japan(Zheng, 2005).

Fourth, heavy reliance on self-support logistics is the norm without effective cooperative mechanisms. Most of China's large-to-medium retailers have self-support logistic centers. According to statistics by China Franchise store Association, the figure stands at 80 percent among top 100 domestic retailers with an average logistics floor space of 9693 meters, while only 13 percent of retailers rely on third-party logistics. Third-party logistics operation is a relatively new idea in China with low logistic service qualities; Most of logistic operators have evolved from previous storage and transport companies, with no core competitiveness, low technical and management levels, inadequate growth momentum and are therefore unable to take over all logistic operations of a large retailer (Wang et al., 2008).

IV. China's Franchise Retailers' Developmental Trends and Strategies

First, self-support logistics will grow and mature. It a natural result that flows from expanding retail scales, growing demands for product distribution, and the diversifying of end locations of logistical services. On the global scene, Wal-Mart is the most representative of giant retailers building and sustaining self-support logistical centers. Wal-Mart has 200 plus wholly self-owned, self-funded logistical centers that are geared to providing required products to Wal-Mart stores and ensuring stable storefront operations. International retailers like Carrefour, Metro and Sears all have modern self-support logistic centers. Some local retailers like Shanghai Hualian and Hangzhou Jiayou have drawn on strong self-owned logistical capabilities and deliver full-spectrum logistical services(Xu, 2006). This mode of logistics covers not only logistical services, but also product sales and the export of management techniques.

Second, third-party logistics will be widely adopted through phases into franchise store retailing. The developing trend in logistics is the rising proportion of logistics outsourced to third parties. With the expansion of logistic scale and upgrading of logistic technologies, some logistical operations are bound to be outsourced to specialized third parties. Statistics collected in foreign countries show that only when third-party logistic operators accounts for 50 percent of a region's logistic operations, logistics as an industry has taken shape. With

the specialization, networked layout, standardization, professionalization of third party logistic operators, franchise store retailers would inevitably be their clients(Zhou, 2006). Following the example set by Beijing Wumei and Huangtianbai, Shenzhen Xinyijia and zhaoshang Logistics also signed deals entrusting the latter with full logistical responsibilities; Guangzhou Haoyouduo has also adopted the third-party distribution mode. In 2005, Shenzhen Xinyijia, with an overall ranking of second place in a Guangdong Province, has signed an agreement with Baogong Logistics, a leading domestic logistic service provider. The agreement outsources Xinyijia's logistical operations to Baogong. In Japan, about 30 percent of franchise store rely heavily on specialized third-party logistic service providers.

Third, fast developing information technologies for logistic use are being applied. Galloping networked computer technologies have been the driving force behind logistic information technologies. From bar code to automated computers, networks, terminal equipments to computer software, everything is being revolutionized. Logistic information technologies are composed of communication, software and business management systems (Xu, 2006). Mobile communication technologies, GPS, GIS, networked computer technologies, automated warehouse management technologies, intelligent labeling technologies, bar code, scanning, information interchange systems are all included. With these technologies as the foundation, an integrated modern logistic management system that spans mobile communication, ERP, monitoring & coordinating management, automated warehouse management, business management, CRM and financial proceedings is taking shape(Luo, 2004). For example, with GPS technologies, users can check the real-time location of their goods, including the position of the carrying vehicle (specific to roads in cities), product names, quantities, and weight. Thus transparency in monitoring is achieved, laying the basis for lowering empty load ratio and optimizing resource allocation. Besides, customers can get hold of logistic information as well, keeping costs in control and enhancing efficiency.

Fourth, the gradual Implementation of a Supply-chain Logistics Management Strategy is highly recommended. Supply chain logistics management means the integration of logistics management has been extended from individual companies to companies throughout the supply chain, and the streamlining of logistics has covered all areas of business. The product diversity and range of franchise store retailers determine it is at the intersection of multiple supply chains and covers many sectors and relates to numerous suppliers. Therefore it's been a competitive strategy that bears on life or death for franchise store

retailers to put relations with upstream and downstream suppliers on the right track and integrate resources with logistical systems. The market environment is fiercely competitive with almost no differences in product range. It is essential for suppliers, dealers and retailers to join efforts in sharing information, lowering logistic costs and speeding up logistic responsiveness. Meanwhile, at the forefront of information gathering, franchise retailers should put in place a strategic management guideline and carry out supply chain logistics management, thus strengthening the central position of franchise retailers in the supply chain (Hu & Yi, 2008).

V. Conclusion

With the development of franchise store retailing and preferential governmental policies, the business scale of franchise store retailing has been expanding and more retailers are growing acutely aware of the vital importance of logistics in the supply chain of franchise store retailing. With more advanced technologies and more streamlined internal development, the room for cost reduction in production and sales is getting smaller, while the logistical links outside production and sales still hold great potential for cost reduction. Modern logistics, especially third-party logistics as part of e-commerce business, has been playing a more and more prominent role in businesses' strategic management. Logistics has become the third pillar and third source of revenue after production and sales. Statistics have shown that the ratio of logistical cost against national GDP is a key indicator of a nation's logistics technological level. The Statistics released by National Reform and Development Commission, National Bureau of Statistics and China Logistics & Purchasing Association have shown that logistical costs accounted for 17.8 percent of GDP in 2011, while that in developed countries like America and Japan stood at 7-8% of GDP. From the makeup of logistical costs, as the main driver of logistical costs, the logistical volume of manufactured industrial products reached 143.6 trillion, an increase of 13.1 percent year on year, down by 1.5 percent from the previous year, accounting for 90.2 percent of total societal logistical costs. The total logistical volume of imports reached 11.2 trillion, increasing 4.3 percent after adjusting for inflation, the rate of increase down by 17.8 percent from the previous year. The logistical costs of farm produce, recyclable products and residential needs increased respectively by 4.5%, 20.4% and 18.3%.

Logistics means more than the transport of products; it entails sound organizational structures and adaptability to highly volatile market fluctuations. In the process of delivering products to consumers, all elements of the business need to work as a coherent whole. It is a process for the business to restructure itself and improve management as well. On the other hand, streamlined logistics is capable of enhancing franchise stores' competitiveness, with products' quality and prices generally on the same plane, logistics need to be seen as a new front where sales campaigns are unfolding, so that a competitive edge in terms of customer service can be attained. This way, the delivery of required products to customers with the best-possible logistical services at a proper location, within a proper timeframe and at reasonable costs can be realized, which can be summed up as "a comprehensive supply-demand balance" (Wang, 2005). Improving logistical services equals enhancing the core competitiveness of franchise store retailers. Wal-Mart and Carrefour's low-cost, fast-response competitive advantage can be attributed to a large degree to their modern logistic management.

Global economic integration brings both opportunities and challenges. Local Chinese retailers have met head-to-head with the world-class giant retailers on local turf and confronted the unprecedented pressure and threat brought by world retailing tycoons. In order to get ahead in competition, they need to focus on logistical management as a key component of market competition and business competitiveness; furthermore, they need to change the old mindset that prioritizes store management and products' quality while downplays logistical management, and forms a new logistical management philosophy that suits the modernization of franchise store retailing. Regarding logistics operational model, a situation-based flexible approach should be preferred over one-size-fit-all solutions and different retail business types should be encouraged to find their own paths to success.

• Received : 2012.04.15

• Accepted : 2012.06.18

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