CHAPTER 10

# CHANNEL CONCEPTS: DISTRIBUTING THE PRODUCT

## LEARNING OBJECTIVES

After reading this chapter, you should:

- Gain insight into the role of distribution channels.
- Understand the methods used in organizing channels.
- Understand the management of underlying behavioral dimensions present in most channels.
- Comprehend the elements of a channel strategy
- Understand the tasks assigned to various channel institutions.

## SAM SIGHTINGS ARE EVERYWHERE

**We began** this book with some insights on Elvis Presley and related marketing problems. Compared to Sam Walton, Elvis sightings are nonexistent. The spirit of Sam Walton permeates virtually every corner of America. This small-town retailer has produced a legacy of U.S. sales of $1 18 billion, or 7% of all retail sales. In the U.S., Wal-Mart has 1,921 discount stores, 512 supercenters, and 446 Sam's Clubs. Wal-Mart recently challenged local supermarkets by opening their new format: Neighborhood Markets. Overall, they have more than 800,000 people working in more than 3,500 stores on four continents.

Today, Wal-Mart is the largest seller of underwear, soap, toothpaste, children's clothes, books, videos, and compact discs. How can you challenge their Internet offerings that now number more than 500,000, with planned expansion of more than 3,000,000? Or the fact that 01' Roy (named after Sam's Irish setter) is now the best-selling dog food brand in America? Besides 01' Roy, Wal-Mart's garden fertilizer has also become the best-selling brand in the U.S. in its category, as has its Spring Valley line of vitamins.

So how do you beat a behemoth like Wal-Mart? One retail expert tackled this question in his autobiography. He suggests 10 ways to accomplish this goal: (1) have a strong commitment to your business; (2) involve your staff in decision making; (3) listen to your staff and your customers; (4) learn how to communicate; (5) appreciate a good job; (6) have fun; (7) set high goals for staff; (8) promise a lot, but deliver more; (9) watch your expenses; and (10) find out what the competition is doing and do something different.

The author of this autobiography: *Made in America-Sam* Walton.

Sources: Murray Raphel, "Up Againsllhe WaJ-Mart," *Direct Marketing,* April 1999, pp. 82-84; Adrienne Sanders, "Yankee Imperialists," *Forbes* December 13,1999, p. 36; Jack Neff, "Wal-:vlart Stores Go Private (Label)," *Advertising Age,* November 29,1999, pp. 1,34,36; Alice Z. Cuneo, "WaJ-Mart's Goal: To Reign Over Web," *Advertising Age,* July 5.1999, pp. 1,27.

## INTRODUCTION

This scenario highlights the importance of identifying the mest efficient and effective manner in which to place a product into the hands of the customer. This mechanism of connecting the producer with the customer is referred to as the *channel oj distribution.* Earlier we referred to the creation of time and place utility. This is the primary purpose of the channel. It is an extremely complex process, and in the case of many companies, it is tile only element of marketing where cost savings are still possible.

In this chapter, we will look at the evoluLion of the channel of distribution. We shall see that several basic functions have emerged that are typically the responsibility of a channel member. Also, it will become clear that channel selection is not a static, once-and-for-all choice, but that it is a dynamic part of marketing planning. As was true for the product, the channel must be managed in order to work. Unlike the product, the channel is composed of individuals and groups that exhibit unique traits that might be in conflict, and that have a constant need to be motivated. These issues will also be addressed. Finally, the institutions or members of the channel will be introduced and discussed.

## THE DUAL FUNCTIONS OF CHANNELS

Just as with the other elements of the firm's marketing program, distribution activities are undertaken to facilitate the exchange between marketers and consumers. There are two basic functions performed between the manufacturer and the ultimate consumer.[1] (See Figure 10.1.) The first, called the *exchange junction,* involves sales of the product to the various members of the channel of distribution. The second, the *physical distribution junction,* moves products through the exchange channel, simultaneously with title and ownership. Decisions concerning both of these sets of activities are made in conjunction with the firm's overall marketing plan and are designed so that the firm can best serve its customers in the market place. In actuality, without a channel of distribution the exchange process would be far more difficult and ineffective.

The key role that distribution plays is satisfying a firm's customers and achieving a profit for the firm. From a distribution perspective, customer satisfaction involves maximizing time and place utility to: the organization's suppliers, intermediate customers, and final

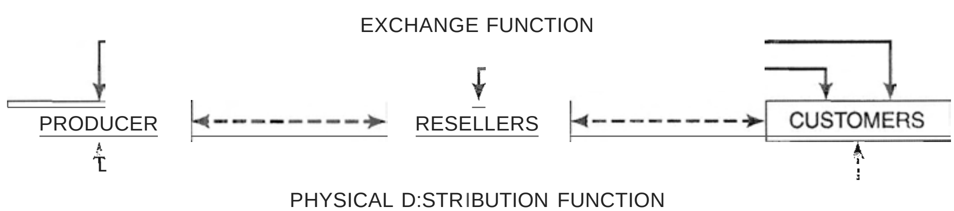



**FIGURE 10.1** Dual-flow system in marketing channels

customers. In short, organizations attempt to get their products to their customers in the most effective ways. Further, as households find their needs satisfied by an increased quantity and variety of goods, the mechanism of exchange-i.e., the channel-increases in importance.

## THE EVOLUTION OF THE MARKETING CHANNEL

As consumers, we have clearly taken for granted that when we go to a supermarket the shelves will be filled with products we want; when we are thirsty there will be a Coke machine or bar around the corner; and, when we don't have time to shop, we can pick-up the telephone and order from the J.C. Penney catalog or through the Internet. Of course, if we give it some thought, we realize that this magic is not a given, and that hundreds of thousands of people plan, organize, and labor long hours so that this modern convenience is available to you, the consumer. It hasn't always been this way, and it is still not this way in many other countries. Perhaps a little anthropological discussion will help our understanding.

The channel structure in a primitive culture is virtually nonexistent. The family or tribal group is almost entirely self-sufficient. The group is composed of individuals who are both communal producers and consumers of whatever goods and services can be made available. As economies evolve, people begin to specialize in some aspect of economic activity. They engage in farming, hunting, or fishing, or some other basic craft. Eventually, this specialized skill produces excess products, which they exchange or trade for needed goods that have been produced by others. This exchange process or barter marks the beginning of formal channels of distribution. These early channels involve a series of exchanges between two parties who are producers of one product and consumers of the other.

With the growth of specialization, particularly industrial specialization, and with improvements in methods of transportation and communication, channels of distribution become longer and more complex. Thus, corn grown in Illinois may be processed into corn chips in West Texas, which are then distributed throughout the United States. Or, turkeys grown in Virginia are sent to New York so that they can be shipped to supermarkets in Virginia. Channels don't always make sense.

The channel mechanism also operates for service products. In the case of medical care, the channel mechanism may consist of a local physician, specialists, hospitals, ambulances, laboratories, insurance companies, physical therapists, home care professionals, and so forth. All of these individuals are interdependent, and could not operate successfully without the cooperation and capabilities of all the others.

Based on this relationship, we define a *marketing channel* as "sets of interdependent organizations involved in the process of making a product or service available for use or consumption, as well as providing a payment mechanism for the provider."

This definition implies several important characteristics of the channel. First, the channel consists of *institutions*, some under the control of the producer and some outside the producer's control. Yet all must be recognized, selected, and integrated into an efficient channel arrangement.

Second, the channel management *process* is continuous and requires constant monitoring and reappraisal. The channel operates 24 hours a day and exists in an environment where change is the norm.

Finally, channels should have certain distribution *objectives* guiding their activities. The structure and management of the marketing channel is thus in part a function of a firm's distribution objective. It is also a part of the marketing objectives, especially the need to make an acceptable profit. Channels usually represent the largest costs in marketing a product.

## FLOWS IN MARKETING CHANNELS

One traditional framework that has been used to express the channel mechanism is the concept of *flow*. These flows, touched upon in Figure 10.2, reflect the many linkages that tie channel members and other agencies together in the distribution of goods and services. From the perspective of the channel manager, there are five important flows.

1. Product flow
2. Negotiation flow
3. Ownership flow
4. Information flow
5. Promotion flow

These flows are illustrated for Perrier Water in Figure 10.2.

The *product flow* refers to the movement of the physical product from the manufacturer through all the parties who take physical possession of the product until it reaches the ultimate consumer. The *negotiation flow* encompasses the institutions that are associated with the actual exchange processes. The *ownership flow* shows the movement of title through the channel. *information flow* identifies the individuals who participate in the flow of information either up or down the channel. Finally, the *promotion flow* refers to the flow of

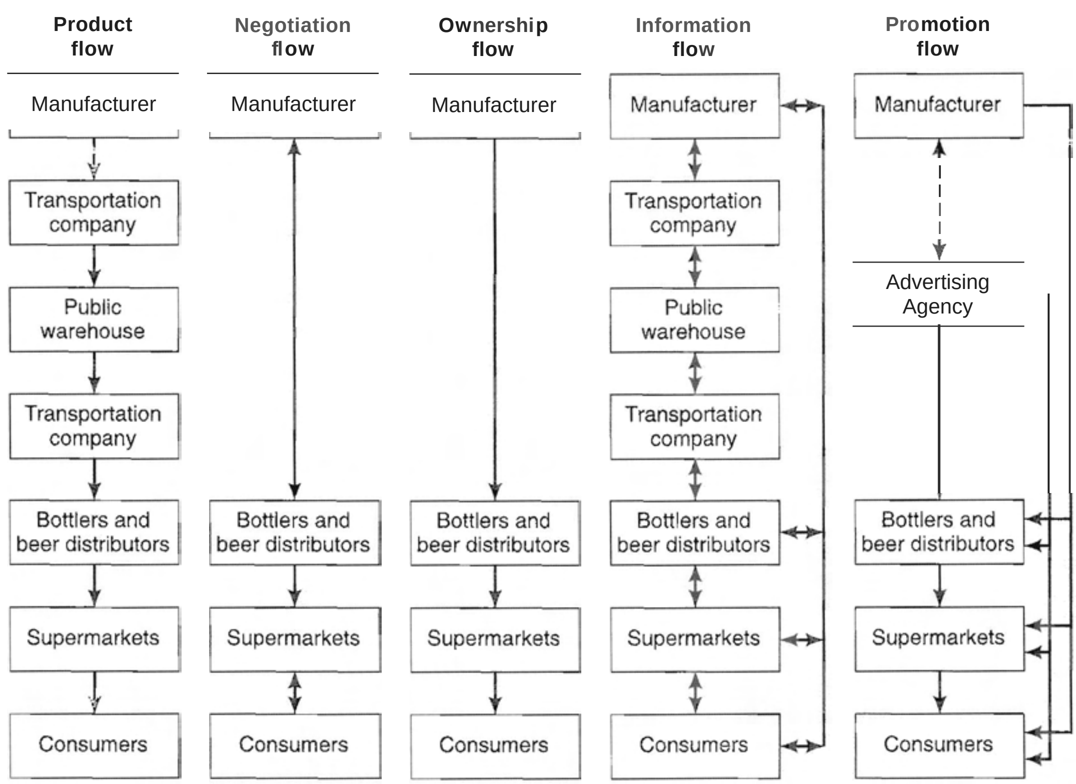



**FIGURE 10-2** Five flows in the marketing channe: for Perrier Water

Source: Bert Rosenbloom, *Marketing Channels: A Management View,* Dryden Press, Chicago, 1983, p. 11.'

persuasive conununication in the form of advertising, personal selling, sales promotion, and public relations.

## FUNCTIONS OF THE CHANNEL

The primary purpose of any channel of distribution is to bridge the gap between the producer of a product and the user of it, whether the parties are located in the same community or in different countries thousands of miles apart. The channel is composed of different institutions that facilitate the transaction and the physical exchange. Institutions in channels fall into three categories: (1) the producer of the product-a craftsman, manufacturer, farmer, or other extractive industry producer; (2) the user of the product- an individual, household, business buyer, institution, or government; and (3) certain middlemen at the wholesale and/or retail level. Not all channel members perform the same function

Heskett[2] suggests that a channel performs three important functions:

1. *Transactional junctions-buying*, selling, and risk assumption.
2. *Logistical junctions-assembly*, storage, sorting, and transportation.
3. *Facilitating junctions-post-purchase* service and maintenance, financing, information dissemination, and channel coordination or leadership.

These functions are necessary for the effective flow of product and title to the customer and payment back to the producer. Certain characteristics are implied in every channel. First, although you can eliminate or substitute channel institutions, the functions that these institutions perform cannot be eliminated. Typically, if a wholesaler or a retailer is removed from the channel, the function they perform will be either shifted forward to a retailer or the consumer, or shifted backward to a wholesaler or the manufacturer. For example, a producer of custom hunting knives might decide to sell through direct mail instead of retail outlets. The producer absorbs the sOlting, storage, and risk functions; the post office absorbs the transportation function; and the consumer assumes more lisk in not being able to touch or try the product before purchase.

Second, all channel institutional members are part of many channel transactions at any given point in time. As a result, the complexity may be quite overwhelming. Consider for the moment how many different products you purchase in a single year, and the vast number of channel mechanisms you use.

Third, the fact that you are able to complete all these transactions to your satisfaction, as well as to the satisfaction of the other channel members, is due to the *routinization* benefits provided through the channel. Routinization means that the right products are most always found in places (catalogues or stores) where the consumer expects to find them, comparisons are possible, prices are marked, and metnods of payment are available. Routinization aids the producer as well as the consumer, in that the producer knows what to make, wnen to make it, and how many units to make.

Fourth, there are instances when the best channel arrangement is direct, from the producer to the ultimate user. This is particularly true when available middlemen are incompetent, unavailable. or the producer feels he can perform the tasks better. Similarly, it may be important for the producer to maintain direct contact with customers so that quick and accurate adjustments can be made. Direct-to-user channels are common in industrial settings, as are door-to-door selling and catalogue sales. Indirect channels are more typical and result, for the most part, because producers are not able to perfonn the iasks pmvided by middlemen. (See Figure 10.3.)

Finally, although the notion of a channel of distribution may sound unlikely for a service product, such as health care or air travel, service marketers also face the problem of

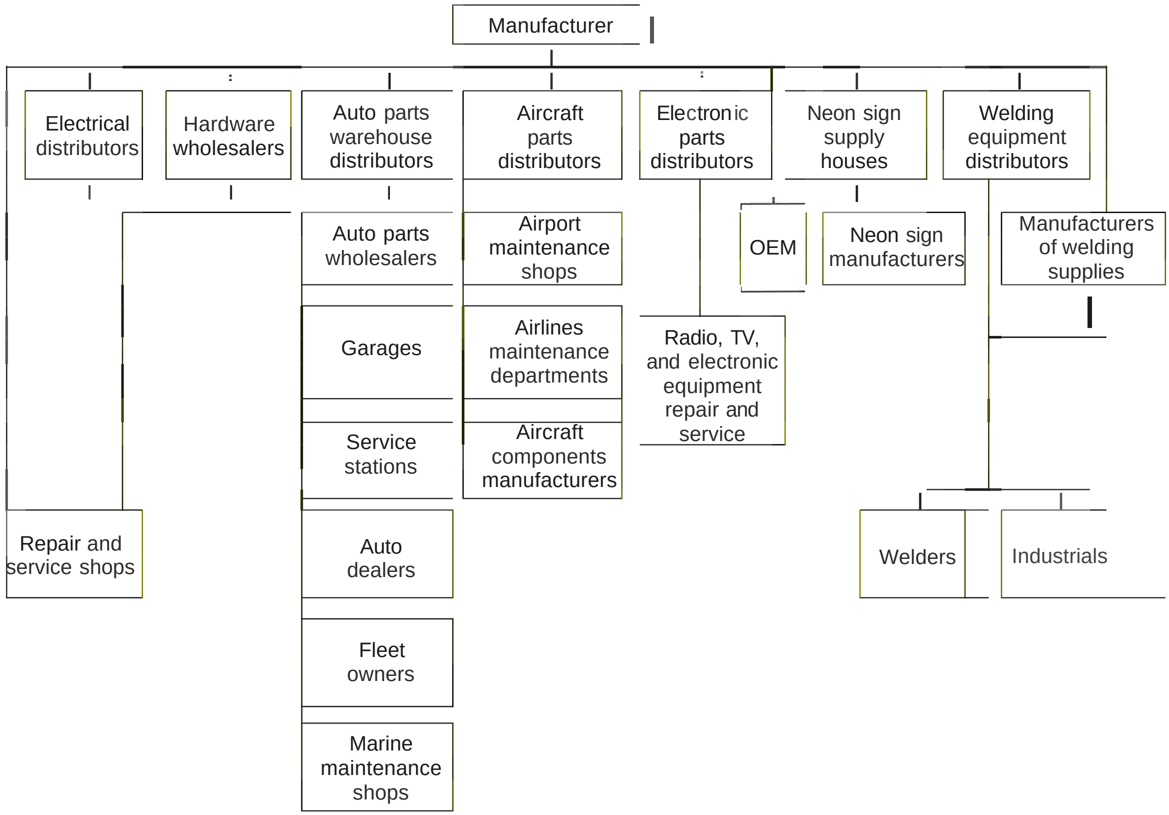



**FIGURE 10.3** Marketing channels of a manufacturer of electrical wire and cable

Source: Edwin H. Lewis, *Marketing Electrical Apparatus and Supplies,* McGraw-Hill, Inc., 1961, p. 215.

delivering their product in the form, at the place and time their customer demands. Banks have responded by developing bank-by-mail, Automatic Teller Machines (ATMs), and other distribution systems. The medical community provides emergency medical vehicles, outpatient clinics, 24-hour clinics, and home-care providers. As noted in Figure lOA even performing arts employ distribution channels. In all three cases, the industries are attempting to meet the special needs of their target markets while differentiating their product from that of their competition. A channel strategy is evident.

## CHANNEL INSTITUTIONS: CAPABILITIES AND LIMITATIONS

There are several different types of parties participating in the marketing channel. Some are members, while others are nonmembers. The former perform negotiation functions and participate in negotiation and/or ownership while the latter participants do not.

### Producer and Manufacturer

These firms extract, grow, or make products. A wide array of products is included, and firms vary in size from a one-person operation to those that employ several thousand people and generate billions in sales. Despite these differences, all are in business to satisfy the needs of markets. In order to do this, these firms must be assured that their products are distributed to their intended markets. Most producing and manufacturing firms are not in a favorable position to perform all the tasks that would be necessary to distribute their products directly to their final user markets. A computer manufacturer may know everything about designing the finest personal computer, but know absolutely nothing about making sure the customer has access to the product.

In many instances, it is the expertise and availability of other channel institutions that make it possible for a producer/manufacturer to even participate in a particular market. Imagine the leverage that a company like Frito-Lay has with various supermarket chains. Suppose you developed a super-tasting new snack chip. What are your chances of taking shelf-facings away from Flito-Lay? Zero. Thankfully, a specialty catalog retailer is able to include your product for a prescribeci fee. Likewise, other channel members can be useful to the producer in designing the product, packaging it, pricing it, promoting it, and distributing it through the most effective channels. It is rare that a manufacturer has the expertise found with other channel institutions.

## Retailing

*Retailing* involves all activities required to market consumer goods and services to ultimate consumers who a''e motivated to buy in order to satisfy individual or family needs in contrast to business, institutional, or industrial use. Thus, when an individual buys a computer at Circuit City, groceries at Safeway, or a purse at Ebags.com, a retail sale has been made.

We typically think of a store when we think of a retail sale. However, retail sales are made in ways other than through stores. For example, retail sales are made by door-to-door

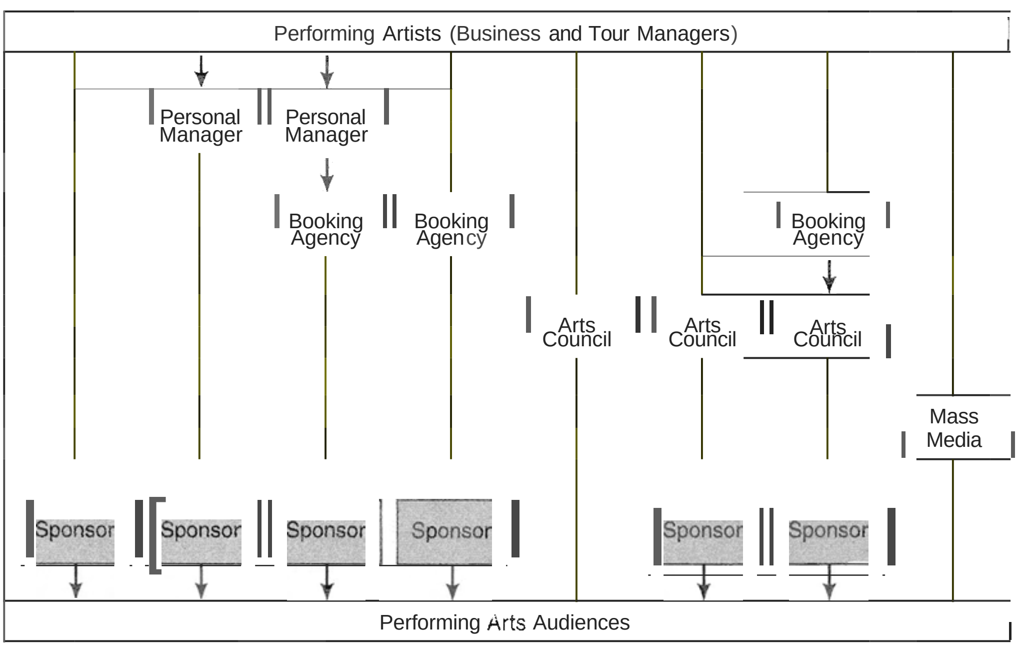



**FIGURE 10.4** The marketing channels for the performing arts

Source: John R. Nevin, "An Empirical Analysis of Marketing Channels for the Performing Arts," in Michael P. Mokwa, William M. Dawson, and E. Arthur Prieve (eds.). *Marketing the Arts,* New York: Praeger Publishers, 1980, p. 204.

salespeople, such as an Avon representative, by mail order through a company such as L.L. Bean, by automatic vending machines, and by hotels and motels. Nevertheless, most retail sales are still made in brick-and-mortar stores.

### *The Structure of Retailing*

Stores vary in size, in the kinds of serv:ces that are provided, in the assortwent of merchandise they carry. and in many other respects. Most stores are small and have weekly sales of only a few hundred dollars. A few are extreIT'ely large, having sales of $500,000 or more on a single day. In fact, on special sale days, some stores have exceeded $1 million in sales.

**Department Stores** Department stores are characterized by their very wide product mixes. That is, they carry many different types of merchandise that may include hardware, clothing, and appliances. Each type of merchandise is typically displayed in a different section or department within the store. The depth of the product mix depends on the store.

**Chain Stores** The 1920s saw the evolution of the chain store movemenL. Because chains were so large, they were able to buy a wide variety of merchandise in large quantity discornts. The discounts substantially lowered their cost compared to costs of single-unit retailers. As a result, they could set retail prices that were lower than those of their small competitors and thereby iflcrease their share of the market. Furthermore, chains were able to attract many customers because of their convenient locations, made possible by the;r financial resources and expertise in selecting locations.

**Supermarkets** Supermarkets evolved in the 1nos and 1930s. For example, Piggly Wiggly Food Stores, founded by Clarence Saunders around 1920, introduced self-service and customer checkout counters. Supermarkets are large, self-service stores with central checkout facilities, they carry an extensive line of food items and often nonfood products.

Supermarkets were among the first to experiment with such innovations as mass merchandising and low-cost distribution methods. Their entire approach to the distribution of food and household cleaning and maintenance products was to make available to the public large assortments of a variety of such goods at each store at a minimal price.

**Discount Houses** Cut-rate retailers have existed for a long time. However, since the end of World War II, the growth of discount houses as a legitimate and extremely competitive retailer has assured this type of outlet a permanent place among retail institutions. It essentially foHowed the growth of the suburbs.

Discount houses are characterized by an emphasis on price as their main sales appeal. Merchandise assortments are generally broad including both hard and soft goods, but assortments are typically limited to the most popular items, colors, and sizes. Such stores are usually large, self-service operations with long hours, free parking, and relatively simple fixtures.

**Warehouse Retailing** Warehouse retailing is a relatively new type of retail institution that experienced considerable growth in the 1970s. Catalog showrooms are the largest type of warehouse retailer, at least in terms of the number of stores operated. Retail sales for catalog showrooms grew from 1 billion dollars in 1970 to over 12 billion today. Their growth rate has slowed recently, but is still substantial.

**Franchises** Over the years, particularly since the 1930s, large chain store retailers have posed a serious competitive threat to small storeowners. One of the responses to this threat has been the rapid growth of franchising. Franchising is not a new development. The major oil companies such as Mobil have long enfranchised its dealers, who only sell the products of the franchiser (the oil companies). Automobile manufacturers also enfrancilise their dealers, who sell a stipulated make of car (e.g., Chevrolet) and operate their business to some extent as the manufacturer wishes.

**Planned Shopping Centers/Malls** After World War II, the United States underwent many changes. Among those most influential on retailing were the growth of the population and of the economy. New highway construction enabled people to leave the congested central cities and move to newly developed suburban residential communities. This movement to the suburbs established the need for new centers of retailing to serve the exploding populations. By 1960 there were 4,500 such centers with both chains and nonchains vying for locations.

Such regional shopping centers are successful because they provide customers with a wide assortment of products. If you want to buy a suit or a dress, a regional shopping center provides many alternatives in one location. *Regional centers* are those larger centers that typically have one or more department stores as major tenants. *Community centers* are moderately sized with perhaps a junior department store; while neighborhood centers are small, with the key stOfe usually a supermarket. *Local clusters* are shopping districts that have simply grown over time around key intersections, courthouses, and the like. *String street locations* are along major traffic routes, while isolated locations are freestanding sites not necessarily in heavy traffic areas. Stores in isolated locations must use promotion or some other aspect of their marketing mix to attract shoppers. Still, as indicated in the next Newsline, malls are facing serious problems.

## *NEWSLINE: THE MALL: A THING OF THE PAST?*

She was born into retail royalty, a double-decker shrine to capitalism that seduced cool customers and wild-eyed shopaholics alike to roam her exhausting mix of 200 stores Her funky, W-shaped design was pure 1960s, as if dreamed up by that era's noted architectural whiz, Mike Brady. When her doors opened the first morning, a brass band serenaded the arriving mob.

Cinderella City, once the biggest covered mall on the planet, was a very big deal-for about six years, until the next gleaming mall came along in 1974. That's when the music stopped at Cinderella City. Soon the patrons grew scarce, the concrete began crvmbling and graffiti stained some of the walls. It's not pretty, but that's the cold law of the consumer jungle. One minute you're luring shoppers from miles around to chug an Orange Julius or grab a snack at the Pretzel Hut; a few years go by, and they're planting you in the dreaded mall graveyard.

Back then, people made a day out of wandering the massive concourses and lunching in the food courts. Today, with less free time available for many people, shopping is seen as a necessity. Spending time with your family and at home is more important than spending time in a store.

The newest malls reflect the modern need for shopping speed. Covered shopping centers now come equipped with dozens of doors to the outside instead of two main entrances that usher crowds in and out through the anchor department store. That same trend paved the way for the flurry of freestanding Home Depots and TJ Maxx stores as well as discount giants like Wal-Mart. All are sapping customers from mid-market malls, already struggling. In addition to the fresh success of freestanding discount stores, the Internet is drawing off even more customers who seeK to buy books or music online.

For the mall to survive, they'll have to be something different—a high-quality environment for the aelivery of high touch, high experience, high margin retail goods and services: a place you go for the entertainment shopping experience.

Sources: Herb Greenberg, "Dead Mall Walking," *Fortune,* July 8, 2000, p. 304; Calmetla Y. Coleman, "Making Malls (Gasp!] Convenient," The Walt *Street Journal*, February 8, 2000, pp. B1, B2; Bill Briggs. "Birth and Death of the American Mall," *The Denver Post,* June 4, 2000, pp. D1, D4.

**Nonstore Retailing** Nonstore retailing describes sales made to ultimate consumers outside of a traditional retail store setting. In total, nonstore retailing accounts for a relatively small percentage of total retail sales, but it is growing and very important with certain types of merchandise, such as life insurance, cigarettes, magazines, books, CDs, and clothing.

One type of nonstore retailing used by such companies as Avon, Electrolux, and many insurance agencies is *in-home selling.* Such sales calls may be made to preseiected prospects or in some cases on a cold call basis. A variation of door-to-door selling is the *demonstration party*. Here one customer acts as a host and invites friends Tupperware has been very successful with this approach.

Vending machines are another type of nonstore retailing. *Automated vending* uses coin-operated, self-service machines to make a wide variety of products and services available to shoppers in convenient locations. Cigarettes, soft drinks, hosiery, and banking transactions are but a few of the items distributed in this way. This method of retailing is an efficient way to provide continuou; service. It is particularly useful with convenience goods.

*Mail order* is a form of nonstore retailing that relies on product description to sell merchandise. The communication with the customer can be by flyer or catalog. Magazines, CDs, clothing, and assorted household items are often sold in this fashion. As with vending machines, mail order offers convenience but limited service. It is an efficient way to cover a very large geographical area when shoppers are not concentrated in one location. Many retailers are moving toward the use of newer communications and computer technology in catalog shopping

*Online marketing* has emerged during the last decade; it requires that both the retailer and the consumer have computer and modem. A modem connects the computer to a telephone line so that the computer user can reach various online information services. There are two types of oniine channels: (1) commercial online channels-various companies have set up online information and marketing services that can be assessed by those who have signed up and paid a monthly fee, and (2) Internet—a global web of some 45,000 computer networks that is making instantaneous and decentralized global communication possible. Users can send e-mail, exchange views, shop for products, and access real-time news.

Marketers can carryon online marketing in four ways: (1) using e-mail; (2) participating in forums, newsgroups, and bulletin boards; (3) placing ads online; and (4) creating an electronic storefront. The last two options represent alternative forms of retailing. Today, more than 40,000 businesses have established a home page on the Internet, many of which serve as electronic storefronts. One can order clothing from Lands' End or lC. Penney, books from B. Dalton or Amazon.com, or flowers from Lehrer's Flowers to be sent anywhere in the world. Essentially, a company can open its own store on the Internet.

Companies and individuals can place ads on commercial online services in three different ways. First, the major commercial online services offer an ad section for listing classified ads; the ads are listed according to when they arrived, with the latest ones heading the list. Second, ads can be placed in certain online newsgroups that are basically set up for commercial purposes. Finally, ads can also be put on online billboards; they pop up while su)scribers are using the service, even though they did not request an ad.

*Catalog marketing* occurs when companies mail one or more product catalogs to selected addresses that have a high likelihood of placing an order. Catalogs are sent by huge general-merchandise retailers-lC. Penney's, Spiegel- that carry a full line of merchandise. Specialty department stores such as Neiman-Marcus and Saks Fifth Avenue send catalogs to cultivate an upper-middle class market for high-pliced, sometimes exotic merchandise.

INTEGRATED MARKETING

## *THE DEATH OF RETAILING GREATLY EXAGGERATED*

Recently, the MIT economist Lester Thurow suggested that e-commerce could mean the end of 5,000 years of conventional retailing if online stores can combine price advantages with a pleasant virtual shopping experience. Let's face it: the growth of malls and megastores have shown that people want selection, con.venience, and low prices, and that's about it. Sure, people say they'd rather shop from the mom-and-pop on Main Street. But if the junk chain store out on the highway has those curling irons for a dollar less, guess where people go?

So a few years into the e:COlrunerce revolution, here are a few observations and predictions:

- Online stores need to become easier to use as well as completely trustworthy.
- If people can go online and get exactly what they get from retail stores for less money, that is precisely what they will do.
- Some stores will have a kind of invulnerability to online competition; i.e., stores that sell last-minute items or specialty items that you have to see.
- Retail stores may improve their chances by becoming more multidimensional; i.e., they have to be fun to visit.

Still, not everything is rosy for e-tailers. Research provides the following insights:

- For net upstarts, the cost per new customer is $82, compared to $3I for traditional retailers.
- E-tailers' customer satisfaction levels were: 41% for customer service; 51% for easy returns; 57% for better product infonnation; 66% for product selection; 70% for price, and 74% for ease of use.
- Repeat buyers for e-tailers was 21% compared to 34% for traditional retailers.

Suggestions to improve the plight of e-tailers include the following:

- Keep it simple.
- Think like your customer.
- Engage in creative marketing.
- Don't blow everything on advertising.
- Don't undercut prices.

While all this advice is good, the recent roller coaster ride of high-tech stocks and its disappointing results for e-tailers has completely changed the future of e-tailing. While e-taiIers have spent about $2 billion industry-wide on advertising campaigns, they often devote far less attention and capital to the quality of services their prospective customers receive once they arrive on site. E-tailers are learning what brick and mortar retailers have known all along, that success is less about building market share than about satisfying and retaining customers who can generate substantial profits.

Sources: Heather Green, "Shake Out E-Tailers," *Business Week*, May 15, 2000, pp. 103-106; Ellen Neubome, "It's the Service, Stupid," *Business Week*, April 3. 2000. p. E8; Chris Ott; "Will Online Shopping Kill Traditional Retail?" *The Denver Business Journal*, Oct. 28. 1999, p. 46A; Steve Caulk, "Online Merchants Need More Effective Web Sites," *Rocky Mountain News*. Thursday, March 8. 2001, p. 5B.

Several major corporations have also acquired or developed mail-order divisions via catalogs. Using catalogs, Avon sells women's apparel, W.R. Grace sells cheese, and General Mills sells sport shirts.

Some companies have designed "customer-order placing machines," i.e., *kiosks* (in contrast to vending machines, which dispense actual products), and placed them in stores, airports, and other locations. For example, the Florsneim Shoe Company includes a machine in several of its stores in which the customer indicates the type of shoe he wants (e.g., dress, sport), and the color and size. Pictures of Florsheim shoes that meet his criteria appear on the screen.

## Wholesaling

Another important channel member in many dishbution systems is the wholesaler. *Wholesaling* includes all activities required to market goods and services to businesses, institutions, or industrial users who are motivated to buy for resale or to produce and market other products and services. When a bank buys a new computer for data processing, a school buys audio-visual equipment for classroom use, or a dress shop buys dresses for resale, a wholesale transaction has taken place.

The vast majority of all goods produced in an advanced economy have wholesaling involved in their marketing. This includes manufacturers. who operate sales offices to perform wholesale functions, and retailers, who operate warehouses or otherwise engage in wholesale activities. Even the centrally planned socialist economy needs a structure to handle the movement of goods from the point of production to other product activities or to retailers who distribute to ultimate consumers. Note that many establishments that pelfonn wholesale functions also engage in manufactwing or retailing. This makes it very difficult to produce accurate measures of the extent of wholesale activity. For purposes of keeping statistics, the Bureau of the Census of the United States Department of Commerce defines wholesaling in terms of the percent of business done by establishments who are primary wholesalers. It is estimated that only about 60% of all wholesale activity is accounted for in this way.

Today there are approximately 600,000 wholesale establishments in the United States, compared to just fewer than 3 million retailers. These 600,000 wholesalers generate a total volume of over 1.3 trillion dollars annually; this is approximately 75% greater than the total volume of all retailers. Wholesale volume is greater because it includes sales to industrial users as well as merchandise sold to retailers for resale.

### Functions of the Wholesaler

Wholesalers perforrn a number of l.seful functions within the channel of distributions. These may include all or some combination of the following:

1. *Warehousing-the* receiving, storage, packaging, and the like necessary to maintain a stock of goods for the customers they service.
2. *Inventory control and order processing-keeping* track of the physical inventory, managing its composition and level, and processing transactions to insure a smooth flow of merchandise from producers to buyers and payment back to the producers.
3. *Transportation-arranging* the physical movement of merchandise.
4. *Information-supplying* information about markets to producers and information about products and suppliers to buyers.
5. *Selling-personal* contact with buyers to sell products and service.

In addition, the wholesaler must perform all the activities necessary for the operation of any other business such as planning, financing, and developing a marketing mix. The five functions listed previously emphasize the nature of wholesaling as a link between the producer and the organizational buyer.

By providing this linkage, wholesalers assist both the producer and the buyer. From the buyer's perspective, the wholesaler typically brings together a wide assortment of products and lessens the need to deal directly with a large number of producers. This makes the buying task much more convenient. A hardware store with thousands of items from hundreds of different producers may find it more efficient to deal with a smaller number of wholesalers. The wholesaler may also have an inventory in the local market, thus speeding delivery and improving service. The wholesaler assists the producer by making products more accessible to buyers. They provide the producer with wide market coverage information about local market trends in an efficient manner. Wholesalers may also help with the promotion of a producer's products to a local or regional market via advertising or a sales force to call on organizational buyers.

### *Types of Wholesalers*

There are many different types of wholesalers. Some are independent; others are part of a vertical marketing system. Some provide a full range of services; others offer very specialized services. Different wants and needs on the part of both buyers and producers have led to a wide variety of modern wholesalers. Table 10.1 provides a summary of general types. Wholesaling activities cannot be eliminated, but they can be assumed by manJfacturers and retailers. Those merchant wholesalers who have remained viable have done so by providing improved service to suppliers and buyers. To do this at low cost, modem technologies must be increasingly integrated into the wholesale operation.

## Physical Distribution

In a society such as ours, the task of physically moving, handling and storing products has become the responsibility of marketing. In fact, to an individual firm operating in a high-levei economy, these logistical activities are critical. They often represent the only cost-saving area open to the firm. Likewise, in markets where product distinctiveness has been reduced greatly, the ability to excel in physical distribution activities may provide a true competitive advantage. Ultimately, *physical distribution* activities provide the bridge between the production activities and the markets that are spatially and temporally separated.

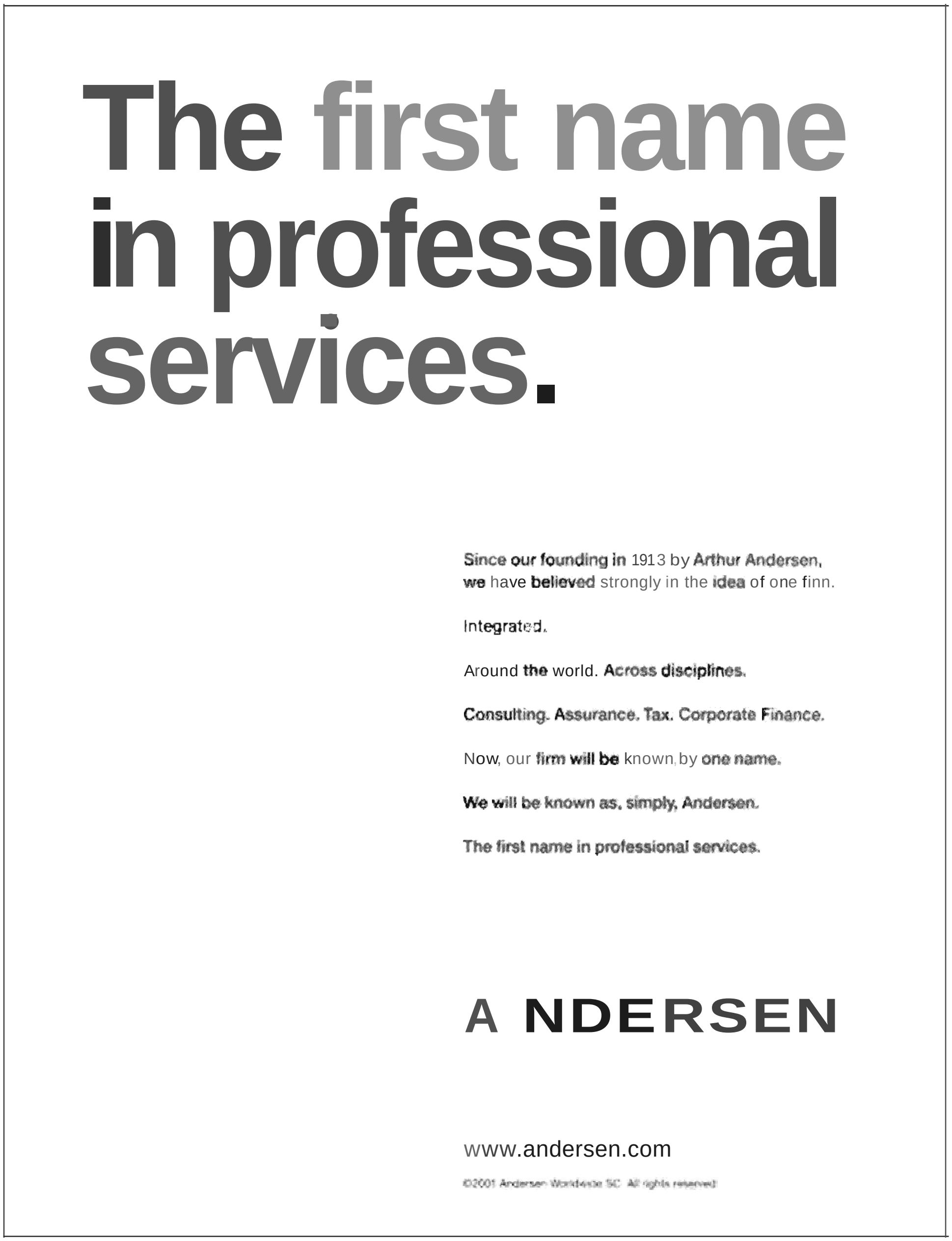
*Physical distribution management* may be defined as the process of strategically managing the movement and storage of materials, parts, and finished inventory from suppliers, between enterprise facilities, and to customers. Physical distribution activities include those undertaken to move finished products from the end of the production line to the final consumer. They also include the movement of raw materials from a source of supply to the beginning of the production line, and the movement of parts, etc., to maintain the existing product. Finally, it may include a network for moving the product back to the producer or reseller, as in the case of recalls or repair.

Before discussing physical distribution, it is important to recognize that physical distribution and the channel of distribution are not independent decision areas. They must be considered together in order to achieve the organization's goal of satisfied customers. Several relationships exist between physical distribution and channels, including the following:

1. Defining the physical distribution standards that channel members want.
2. Making sure the proposed physical distribution program designed by an organization meets the standards of channel members.

3. Selling channel members on physical distribution programs.
4. Monitoring the results of the physical distribution program once it has been implemented.

Figure 10.5 illustrates the components of physical distribution management.




**AD** 10.1 Andersen appeals to both institutions and individuals.

**TABLE 10.1 Tvpes of Modern Wholesalers**

| Type | Definition | Subcategories |
|---|---|---|
| Full-service merchandise wholesaler | *Take title* to the merchandise and assume the risk involved in an independent operation; buy and resell products; offer a complete range of services. | • General<br>• Limited-line |
| Limited-service merchant wholesalers | *Take title* to the merchandise and assume the risk involved in an independent operation; buy and resell products; offer a limited range of services. | • Cash and carry<br>• Rack jobbers<br>• Drop shippers<br>• Mail orders |
| Agents and brokers | *Do not take title* to the merchandise; bring buyers and sellers together and negotiate the terms of the transaction: *agents* merchants represent either the buyer or seller, usually on a permanent basis; *brokers* bring parties together on a temporary basis, | *Agents*<br>• Buying agents<br>• Selling agents<br>• Commission merchants<br>• Manufacturers' age"lts<br>*Brokers*<br>• Real estate<br>• Food<br>• Other products |
| Manufacturer's sales | *Owned directly* by the manufacturers; performs wholesaling functions for the manufacturer, | |
| Facilitator | Perform some *specialized functions* such as finance or warehousing; to facilitate the wholesale transactions; may be independent or owned by producer or buyer. | • Warehouses<br>• Finance companies<br>• Transportation companies<br>. Trade marts |

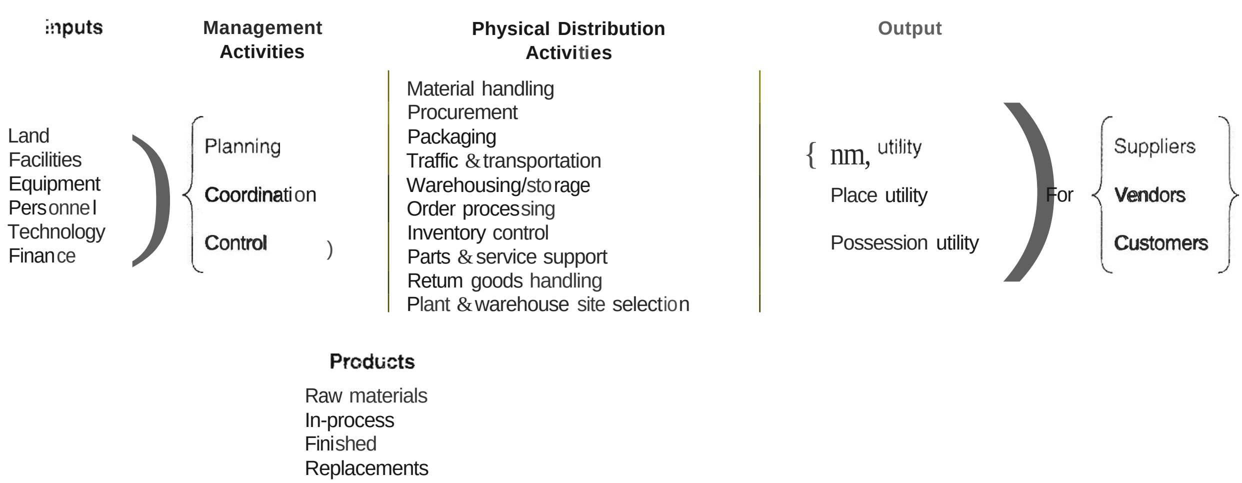



**FIGURE 10.5** The physical distribution management process

MARKETING CAPSULE 1

1. Producers/manufacturers make or assemble the final product provided to the consumer.
2. Retailing involves all activities required to market consumer goods and service to ultimate consumers who are motivated to buy in order to satisfy individual or family needs in contrast to business, institutional, or industrial use. The various types of retailers include:
   a. Department stores
   b. Chain stores
   c. Supermarkets
   d. Discount houses
   e. Warehouse retailing
   f. Franchises
   g. Planned shopping centers
   h. Nonstore retailing
3. Wholesaling includes all activities required to market goods and services to businesses, institutions, or industrial users who are motivated to buy for resale or to produce and market other products/services. The various types of wholesalers include:
   a. Full-service merchandise wholesalers
   b. Limited-service merchant wholesalers
   c. Agents and brokers
   d. Manufacturers' sales representatives
   e. Facilitators

As you can see in Figure 10.5, successful management of the flow of goods from a source of supply (raw materials) to the final customer involves effective planning, implementation, and control of many distribution activities. These involve raw material, in-process inventories (partially completed products not ready for resale), and finished products. Effective physical distribution management results initially in the addition of time, place, and possession utility of products; and ultimately, the efficient movement of products to customer and the enhancement of the finn's marketing efforts.

Physical distribution represents both a cost component and a marketing tool for the purpose of stimulating customer demand. The major costs of physical distribution include transportation, warehousing, carrying inventory, receiving and shipping, packaging, administration, and order processing. The total cost of physical distribution activities represents 13.6% for reseller companies. Poorly managed physical distribution results in excessively high costs, but substantial savings can occur via proper management.

Physical distribution also represents a valuable marketing tool to stimulate consumer demand. Physical distribution improvements that lower prices or provide better service are attractive to potential customers. Similarly, if finished products are not supplied at the right time or in the right places, firms run the risk of losing customers.

## ORGANIZING THE CHANNEL

Either through a planned process or through a natural evolution, channels of distribution reflect an observable organization structure. Three types are most common: conventional channels, vertical marketing systems, and horizontal channel systems.

### Conventional Channels

The *conventional channel* of distribution could be described as a group of independent businesses, each motivated by profit, and having little concern about any other member of the distribution sequence. There are no all-inclusive goals, and in many instances, the assignment of tasks and the evaluation process are totally informal. Consequently, channel frameworks might be working against one another, tasks may go undone, and ineffective channel member relationships may last for years. Despite these deficiencies, this type of channel structure remains most common, and there are numerous examples of such networks working.

## Vertical Marketing Systems

Vertical marketing systems have emerged as a solution to the problems of conventional networks. A *vertical marketing system* (VMS) comes about when a member of the distribution channel (usually the manufacturer) assumes a leadership role and attempts to coordinate the efforts of the channel so that mutually beneficial goals can be attained. Three forms of vertical integration are now common.

### *Administered VMS*

The *administered VMS* is very close to the conventional network, but differs in that it is informally guided by goals and programs deveioped by one or a limited number of firms in the existing channel. This framework is the source of the concept of a *channel captain*, in that administrative skills and the power of one individual may be the driving force of the channel. Often the dominant brands, as in the case of Xerox or Procter & Gamble, are able to manifest this cooperation.

Through the recognition of a channel leader, the distribution networks function better, sales and profits are higher, product exposure improves, inventory management systems are initiated, and the coordination of promotional activities becomes a reality. An administered system is not without its problems. Often, this effort is placed on the shoulders of a single individual. Another drawback is the tendency of polarizing channel members. Businesses either become part of the VMS or remain strongly independent. Eventually these independents may find themselves at a tremendous competitive disadvantage, and may even be deprived of certain channel benefits.

### *Contractual VMS*

There are instances when channel members wish to formalize their relationship by employing a contractual agreement, known as a *contractual VMS*. This provides additional control, and either explicitly or implicitly spells out the marketing functions to be performed by all the members of the channel. This is the most popular form of vertical marketing arrangement.

### *Corporate VMS*

When channel members on different levels are owned and operated by one organization, *a corporate vertical marketing system* is said to exist. Such integration can be forward or backward. A manufacturer who owns the various intelmediaries in its channel network has engaged in *forward* integration. A retailer who takes over the wholesaling and manufacturing tasks is *backward* integrating. This process can entail either the organization's purchasing the institutions, or establishing its own facilities. Although partial forward or backward integration is most common, total integration is becoming more popular. Manufacturers who have recently integrated through to the retail level are Dannon Yogurt, Blue Bell Ice Cream, and Pepperidge Farms. Sears and Safeway stores are two retailers that have successfully integrated backward. American Hospital Supply Cornoration is an example of a wholesaler that has integrated both backward and forward.

## Horizontal Channel Systems

There are instances where two or more companies are unable to acquire the capital, or don't have the technical or production know-how, to effectively market their products alone. **In** such cases, these companies may establish a temporary or quasi-pelmanent relationship in order to work with each other, and create the channel mechanism required to reach their target markets. This arrangement has been labeled a *horizontal channel* system. For example, two small manufacturers might combine their shipments to common markets in order to gain full carload transportation rates that each could not obtain separately. Another common scenario is for a large retailer to buyout several competing small retailers in order to gain entry into certain markets or with certain customers.

## THE CHANNEL MANAGEMENT PROCESS

Evidence suggests that a channel should be managed just like the product, promotion, and pricing functions. This channel management process contains five steps.

### Analyze the Consumer

We begin the process of channel management by answering two questions. First, to whom shall we sell this merchandise immediately? Second, who are our ultimate users and buyers? Depending upon a host of factors, including the type of product, functions performed in the channel, and location in the channel, the immediate and ultimate customers may be identical or they may be quite separate. In both cases, some fundamental questions would apply. There is a need to know what the customer needs, where they buy, when they buy, why they buy from certain outlets, and how they buy.

It is best that we first identify the traits of the ultimate user, since the results of this evaluation might determine the other channel institutions we would use to meet these needs. For example, the buying characteristics of the purchaser of a high-quality VCR might be as follows:

1. Purchased only from a well-established, reputable dealer.
2. Purchased only after considerable shopping to compare prices and merchandise characteristics.
3. Purchaser willing to go to some inconvenience (time and distance) to locate the most acceptable brand.
4. Purchased only after extended conversations involving all interested parties, including dealer, users, and purchasers.
5. Purchase may be postponed.
6. Purchased only from a dealer equipped to render prompt and reasonable product service.

These buying specifications illustrate the kinds of requirements that the manufacturer must discover. In most cases, purchase specifications are fairly obvious and can be discovered without great difficulty. On the other hand, some are difficult to determine. For example, certain consumers will not dine at restaurants that serve alcohol; others will patronize only supermarkets that exhibit definite ethnic characteristics in their merchandising. Nonetheless, by careful and imaginative research, most of the critical factors that bear on consumer buying specifications can be determined.

Knowing the buying specifications of consumers, the channel planner can decide on the type or types of wholesaler and/or retailer through which a product should be sold. This requires that a manufacturer contemplating distribution through particular types of retailers become intimately familiar with the precise location and performance characteristics of those he is considering.

In much the same way that buying specifications of ultimate users are determined, the manufacturers must also discover buying specifications of resellers. Of particular importance is the question, "from whom do my retail outlets prefer to buy?" The answer to this question determines the types of wholesalers (if any) that the manufacturer should use. Although many retailers prefer to buy directly from the manufacturers, this is not always the case. Often, the exchange requirements of manufacturers (e.g., infrequent visits, large order requirements, and stringent credit temls) are the opposite of those desired by retailers. Such retailers would rather buy from local distributors who have lenient credit terms and offer a wide assortment of merchandise.

## Establish the Channel Objectives

The channel plan is derived from channel objectives. They are based on the requirements of the purchasers and users, the overall marketing strategy, and the long-run goals of the corporation. However, in cases when a company is just getting started, or an older company is trying to carve out a new market niche, the channel objectives may be the dominant objectives. For example, a small manufacturer wants to expand outside the local market. An immediate obstacle is the limited shelf space available to this manufacturer. The addition of a new product to the shelves generally means that space previously assigned to competitive products must be obtained. Without this exposure, the product is doomed.

As one would expect, there is wide diversity of form that channel objectives can take. The following areas encompass the major categories:

1. Growlh in sales- by reaching new markets, and/or increasing sales in existing markets.
2. Maintenance or improvement of market share--educate or assist channel components in their efforts to increase the amount of product they handle.
3. Achieve a pattern of distribution-struCture the channel in order to achieve certain time, place, and form utilities.
4. Create an efficient channel-improve channel performance by modifying various flow mechanisms.

## Specify Distribution Tasks

After the distribution objectives are set, it is appropriate to determine the specific distribution tasks (functions) to be performed in that channel system. The channel manager must be far more specific in describing the tasks, and must define how these tasks will change depending upon the situation. An ability to do this requires the channel manager to evaluate all phases of the distribution network. Tasks must be identified fully, and costs must be assigned to these tasks. For example, a manufacturer might delineate the following tasks as being necessary in order to profitably reach the target market:

- Provide delivery within 48 hours after order placement
- Offer adequate storage space
- Provide credit to other intermediaries
- Facilitate a product return network
- Provide readily available inventory (quantity and type)
- Provide for absorption of size and grade obsolescence

## Evaluate and Select from Channel Alternatives

Detennining the specific channel tasks is a prerequisite for the evaluation and selection process. There are four bases for channel alternatives: (1) number of levels, (2) intensity at the various levels, (3) types of intermediaries at each level, and (4) application of selection criterion to channel alternatives.[3]

### *Number of Levels*

Channels can range in levels from two to several (five being typical). The two-level channel (producer to consumer) is a direct channel and is possible only if the producer or customer are willing to perform several of the tasks performed by intermediaries. The number of levels in a particular industry might be the same for all the companies simply because of tradition. In other industries, this dimension is more flexible and subject to rapid change.

### *Intensity at Each Level*

Once the number of levels has been decided, the channel manager needs to determine the actual number of channel components involved at each level. How many retailers in a particular market should be included in the distribution network? How many wholesalers? Although there are limitless possibilities, the categories shown in Figure 10.6 have been used to describe the general alternatives.

The intensity decision is extremely critical, because it is an important part of the firm's overall marketing strategy. Companies such as Coca-Cola and Timex watches have achieved high levels of success through their intensive distribution strategy.

### *Types of Intermediaries*

As discussed earlier, there are several types of intermediaries that operate in a particular channel system. The objective is to gather enough information to have a general understanding of the distribution tasks these intermediaries perform. Based on this background information, several alternatives will be eliminated.

(1) *Exclusive distribution* (such as Ethan Allen and Drexel Heritage Furniture)

- The use of a single or very few outlets
- Creates high dealer loyalty and considerable sales support
- Provides greater control
- Limits potential sales volume
- Success of the product is dependent upon the ability of a single intermediary

(2) *Intensive distribution* (such as candy)-the manufacturer attempts to get as many intermediaries of a particular type as possible to carry the product

- Provides for increased sales volume, wider consumer recognition, and considerable impulse purchasing
- Low price, low margin, and small order sizes often result
- Extremely difficult to stimulate and control this large number of intermediaries

(3) *Selective distribution* (such as Baskin-Robbins)-an intermediary strategy, with the exact number of outlets in any given market dependent upon market potential, density of population, dispersion of sales, and competitors' distribution policies

- Contains some of the strengths and weaknesses of the other two strategies.
- It is difficult to determine the optimal number of intermediaries in each market

**FIGURE 10.6** Levels of channel intensity

Having identified several possible alternative channel structures, the channel manager is now at a place where he or she can evaluate these alternatives with respect to some set of criteria. Company factors, environmental trends, reputation of the reseller, experience of reseller are just a few examples.

### *Who Should Lead*

Regardless of the channel framework selected, channels usually perform better if someone is in charge, providing some level of leadership. Essentially, the purpose of this leadership is to coordinate the goals and efforts of channel irstitutions. The level of leadership can range from very passive to quite active-verging on dictatorial. The style may range from very negative, based on fear and punishment, to very positive, based on encouragement and reward. In a given situation, any of these leadership styles may prove effective.

Given the restrictions inherent in channel leadership, the final question is "who should lead the channel?" Two important trends are worth noting, since they influence the answer. First, if we look at the early years of marketing, i.e., pre-I92G, the role of the wholesaler (to bring the producer and consumer together) was most vital. Consequently, during this period, the wholesaler led most channels. This is no longer true. A second trend is the apparent strategy of both manufacturers and retailers to exert power through size. In a type of business cold war, manufacturers and retailers are constantly trying to match each other's size. The result has been some serious warfare to gain channel superiority.

Under which conditions shouid the manufacturers lead? The wholesaler? The retailer? While the answer is contingent upon many factors, in general, the manufacturer should lead if control of the product (merchandising, repair) is critical and if the design and redesign of the channel is best done by the manufacturer. The wholesaler should lead where the manufacturers and retailers have remained small in size, large in number, relatively scattered geographically, are financially weak, and lack marketing expertise. The retailer should lead when product development and demand stimulation are relatively unimportant and when personal attention to the customer is important.

## Evaluating Channel Member Performance

The need to evaluate the performance level of the channel members is just as important as the evaluation of the other marketing functions. Clearly, the marketing mix is quite interdependent and the failure of one component can cause the failure of the whole. There is one important difference, with the exception of the corporate VMS; the channel member is dealing with independent business firms, rather than employees and activities under the control of the channel member, and their willingness to change is lacking.

Sales is the most popular performance criteria used in channel evaluation. Sales might further be subdivided into current sales compared with historical sales, comparisons of sales with other channel members, and comparisons of the channel member's sales with predetermined quotas. Other possible performance criteria are: maintenance of adequate inventory, selling capabilities, attitudes of channel intermediaries toward the product, competition from other intermediaries and from other product line carried by the manufacturers own channel members.

### *Correcting or Modifying the Channel*

As a result of the evaluation process, or because of other factors such as new competition, technology, or market potential, changes will be made in the channel structure. Because channel relationships have tended to be long-term, and the channel decision has such a pervasive impact on the business, great care should be taken before changing the status quo.

Terminations of channel members not performing at minimum performance standards should be employed only as a last resort. Corrective actions are far less destructive and maintain the goodwill that is so crucial in channel relationships. This requires that the channel manager attempt to find out why these channel members have performed poorly and then implement a strategy to correct these deficiencies.

Sometimes a producer decides that an entirely new channel needs to be added, or an existing one deleted. A manufacturer of camera accessories might decide that he wants to reach the skilled amateur market in addition to the professional photographer market. This would mean designing a different channel, and learning about a different set of intermediaries.

## THE HUMAN ASPECT OF DISTRIBUTION

A channel of distribution by its very nature is made up of people. Ideally, a channel member should coordinate his or her efforts with other members in such a way that the performance of the total distribution system to which he or she belongs is enhanced. This is rarely the case. Part of this lack of cooperation is due to the organization structure of many channels, which encourages a channel member to be concerned only with channel members immediately adjacent to them, from whom they buy and to whom they sell. A second reason is the tendency of channel members to exhibit their independence as separate business operations. It is difficult to gain cooperation under this arrangement. Four human dimensions have been incorporated into the study of channel behavior: roles, communication, conflict, and power. It is assumed that an understanding of these behavioral characteristics will increase the effectiveness of the channel.

### Role

Most channel members participate in several channels. Establishing the *role* of a channel member means defining what the behavior of the channel member should be. For example, a basic role prescription of the manufacturer may be to maximize the sales of his/her particular brand of product. This connotes that the manufacturer is to actively compete for market share, and aggressively promote his or her brand. The role prescriptions of independent wholesalers, however, are likely to be quite different. Since wholesalers may represent several competing manufacturers, his or her role would be to build sales with whatever brands are most heavily demanded by retailers. Therefore, a major issue in channel management relates to defining the role prescriptions of the various participants in order to achieve desired results. This is accomplished through a careful appraisal of the tasks to be performed by each channel member and clear communication of these roles to the members.

### Communication

Channel communication is sending and receiving information that is relevant to the operation of the channel. It is critical for the success of the channel member to work to create and foster an effective flow of information within the channel. Communication will take place only if the channel member is aware of the pitfalls that await. The channel manager should therefore try to detect any behavioral problems that tend to inhibit the effective flow of information through the channel and try to solve these problems before the communication process in the channel becomes seriously distorted.

## Conflict

Anytime individuals or organizations must work together and rely on each other for personal success, conflict is inevitable. *Conflict*, unlike friendly competition, is personal and direct and often suggests a confrontation. Because it is so pervasive in distribution, a great deal of research has been conducted m attempts to identify its causes, outcomes, and solutions.

There is also a need to manage conflict in the channel. This consists of (1) establishing a mechanism for detecting conflict, (2) appraising the effects of the conflict, and (3) resolving the conflict. This last consideration is most difficult to implement. Techniques such as a channel committee, jomt goal setting, and bringing in an arbitrator have all been used. There are even cases when conflict is necessary. Such is the case in the e-marketplace. For example, Anne Mulcahy, President of Xerox General Markets Operation, notes, "Those that don't aggressively embrace multiple channels for multiple products *will* get left behind. The inherent conflict in this business modei is not only a reality of business; it's a sign of a healthy company."

## Power

*Power* is our willingness to use force in a relationship. It is often the means by which we are able to control or influence the behavior of another party. In the channel mechanism, *power* refers to the capacity of a particular channel member to control or influence the behavior of another channel member. For instance, a large retailer may want the manufacturel' to modify the design of the product or perhaps be required to carry less inventory. Both parties may attempt to exert their power in an attempt to influence the other's behavior. T;le ability of either of the parties to achieve this outcome will depend upon the amount of power that each can bring to bear.

### MARKETING CAPSULE

1. Three general alternatives exist in organizing the channel: conventional, vertical, and horizontal.
2. The steps in channel design include the following:
   a. Analyze the consumer
   b. Establish channel objectives
   c. Specify the channel tasks
   d. Select the appropriate channel from available alternatives
   e. Evaluate the results
3. Channels may exhibit several human traits:
   a. Role
   b. 2ommunication
   c. Conflict
   d. Power

THE WALL STREET JOURNAL.

## IN PRACTICE

Marketing channels connect producers and consumers by moving finished goods that are available for consumption. Channel management is a process involving careful planning and monitoring. As with other marketing functions, marketing channels have objectives that guide their activities.

To successfully manage distribution channels, marketers must analyze end consumers, establish channel objectives, specify channel tasks, select the appropriate channel, and evaluate results of the process. If these steps are executed successfully, marketers can help their organizations save costs.

Several professional and trade associations exist for channel managers and those involved in the process. The American Society of Transportation and Logistics (www.astl.org) is a professional organization founded in 1946 by a group of industry leaders to ensure a high level of professionalism and promote continuing education in the field of transportation and logistics.

The National Association of V\'holesalers-Distributors (www.naw.org) comprises over 100 national line-of-trade associations, representing virtually all products that move to market via wholesaler-distributors.

The National Retail Federation (www.nrf.com) conducts programs and services in research, education, training, information technology, and government affairs to protect and advance the interests of the retail industry. NRF also includes in its membership key suppliers of goods and services to the retail industry.

Marketing channels can make or break Internet companies. Many Internet companies attempt to differentiate themselves by providing fast delivery of customer orders anywhere in the world. To achieve this, these companies must successfully manage their marketing channels. The Interactive Journal's Tech Center is an excellent source for all issues related to technology.

Keep apprised of emerging technologies, developments in specific companies, and industry trends by reading articles in Tech Center and Marketplace.

## DELIVERABLE

Use the Interactive Journal to search for articles about one organization that successfully manages channels and one organization that does not. Compare the strategies of both companies and discuss what works and what does not work for each organization. Support your conclusions with concepts fTOm the chapter.

## DISCUSSION QUESTIONS

1. Why do organizations need to effectively manage their channels of distribution? What happens when they do not?
2. How does ineffective channel management affect consumers? An organization's revenue stream?
3. What role does technology play in channel management? What types of technology can organizations use to improve channel management?

## SUMMARY

The complex mechanism of connecting the producer with the consumer is referred to as the *channel of distribution*. This chapter has looked at the evolution of the channel, as well as theoretical explanations for the distribution channel phenomenon. Five "flows" are suggested that reflect the ties of channel members with other agencies in the distribution of goods and services. A channel performs three important functions: (I) transactional functions, (2) logistical functions, and (3) facilitating functions. Channel strategies are evident for service products as well as for physical products. Options available for organizing the channel structure include: (1) conventional channels, (2) vertical marketing systems, (3) horizontal channel systems, and (4) multiple channel networks. Designing the optimal distribution channel depends on the objectives of the firm and the characteristics of available channel options.

The primary members of distribution channels are manufacturers, Wholesalers, and retailers, Retailing is all activities required to market goods and services to the ultimate consumer. This makes retailers who perform such activities an important link in the channel of distribution for many consumer products.

Wholesaling involves all activities required to market goods and services to businesses, institutions, or industrial users who are motivated to buy for resale or to produce and market other products and services. Wholesalers provide a linkage between producers and retailers or industrial users.

Physical distribution management involves the movement and storage of materials, parts, and finished inventory from suppliers, between middlemen, and to customers. Physical distribution activities are undertaken to facilitate exchange between marketers and cuslomers, The basic objective of physical distribution is to provide an acceptable level of customer service at the lowest possible cost. This is done using the total cost concept, which requires that all the costs of each alternative distribution system be considered when a firm is attempting to provide a level of customer selvice.

Channels exhibit behavior, as people do, and this behavior needs to be coordinated and managed in order to reach desired objectives. The four dimensions of behavior examined are role, communication, conflict, and power. Strategies for effective channel management include: (I) analyze the consumer, (2) establish channel objectives, (3) specify the channel tasks, (4) select the appropriate channel from available alternatives. and (5) evaluate the results. The chapter concludes with a discussion of the legal factor's impact on chann:ls.

## MARKETER'S VOCABULARY

**Exchange function** Sales of the product to the various members of the channel of distribution.

**Physical distribution function** Moves the product through the exchange channel, along with title and ownership.

**Marketing channel** Sets of independent organizations involved in the process of making a product or service available for use or consumption as well as providing a payment mechanism for the provider.

**Routinization** The right products are most always found in places where the consumer expects to find them, comparisons are possible, prices are marked, and methods of payment are available.

**Retailing** Involves all activities required to market consumer goods and services to ultimate consumers.

**Nonstore retailing** Sales made to ultimate consumers outside a traditional retail store selting.

**Wholesaling** Includes all activities required to market goods and services to businesses, institutions, or industrial users.

**Conventional channel** A group of independent businesses, each motivated by profit, and having little concern about any other member of the distl'ibution sequence.

**Vertical marketing system** Comes about when a member of the distribution channel assumes a leadership role and attempts to coordinate the efforts of the channel.

**Channel role** Defines what the behavior of the channel member should be.

**Channel conflict** Personal and direct friction; often suggests a potential confrontation.

**Channel power** A willingness to usc force in a relationship.

## DISCUSSION QUESTIONS

1. Discuss the difference between the theories of the sorting concept and the postponement concept.
2. What are the five important "flows" that link channel members and other agencies together in distribution? Explain each type.
3. Define the following three channel functions: (1) transactional, (2) logistical, and (3) facilitating. What would happen to these functions if the middlemen were eliminated from the chain-linking manufacturer to consumer"
4. Why are channels of distribution important for service products?
5. Compare the characteristics of the three forms of vertical marketing systems: administered, contractual, and corporate.
6. What are the advantages to wholesalers of contractual arrangements forming cooperatives with retailers? What are the advantages to retailers"
7. What is an ancillary structure? What is its function in the distribution channel?
8. How do economic condjtions of inflation, recession, and shortages impact upon the channel environment?
9. Discuss situations in which channel conflict may be desirable. How should conflict that produces negative effects be managed?

## PROJECT

Starting with a well-known manufacturer. trace the various channel intermediaries employed. Draw a channel diagram.

## CASE APPLICATION

### CONNECTING CHANNEL MEMBERS

Brokels are in the midst of an identity crisis. Today's brokers represent more than 3.000 manufacturers, comprising nearly 60% of all commodity volume in package goods alJ.d 80% of U.S. grocery warehouse withurawals. Many brokers rank among the top 10 vendors of their major retail customers. Much to their continuing frustration. huwever, many manufacturers are experimenting with some combination of broker and direct resources in an attempt to deal with the new marketplace. Some of these models are working, but managers are not.

"While each manufacturer must develop a host of different strategies to match thai of individual customers, the broker has the luxury to organize his total strategy around his individual customers," says National Food Brokers Association (NFBA) president and CEO Robert Schwarze. Brokers have always been regarded for their local market expertise, but the rapid shift to micromarketing is now regarded as their opportunity to ultimately weave themselves into the very fabric of their principles' go-to-market approach.

Consumers have a lot of shopping alternatives and are taking advantage of them, which is driving manufacturers and retailers to look for consumer information to give them a competitive edge. In just a few years, as brokers have accelerated their use of data, the number of brokers having online access to syndicated data has expanded to more than 200, according to an Andersen Consulting Survey.

Traditionally, panel and retail census data have been used by manufacturers to understand the components of volume and to determine what they can do to grow volume, including the primary variables of penetration and buying rates. Now these same consumer dynamics can be used to understand retail-shopping behavior. Instead of simply measuring how many househoids buy a particular brand, the data measure how many shoppers who buy the brand shop at a particular retailer or retail channel. Depending on where the manufacturer fits on the scale will affect how one thinks about marketing and promotion.

"In the final analysis, understanding a retailer's position in the market is the key," said A.C. Nielsen consumer information and national sales VP Tod Hale. The knowledge about the competitive frame, including individual retailer shopper demographics, purchase behavior in a category, and measures of loyalty by account, are increasingly essential to promotional planning and evaluation. The ability to compare and contrast behavior in different accounts is essential to uncovering the opportunities.

*Questions:*

1. Do you see sources of conflict in this new arrangement?
2. How will role determination be determined?

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