UNIT 13 DISTRIBUTION CHANNELS

Structure

13.0 Objectives

13.1 Introduction

13.2 Concept of Distribution Channel

13.3 Functions of Distribution Channels

13.4 Distribution Channels Used

13.5 Factors Influencing the Choice of Channel

13.6 Channel Design Decisions

13.7 Channel Management

13.8 Channel Conflicts

- 13.8.1 Types of Channel Conflicts
- 13.8.2 Causes of Channel Conflict
- 13.8.3 Managing Channel Conflict

13.9 Let Us Sum Up

13.10 Key Words

13.11 Terminal Questions

13.0 OBJECTIVES

After studying this unit, you should be able to:

- define distribution channel;
- describe functions of distribution channel;
- explain distribution channel flow;
- develop a channel design;
- discuss various steps involved in channel management;
- identify the types and causes of channel conflict; and
- manage the channel conflict.

13.1 INTRODUCTION

The typical geographic separation of the manufacture or producer from the ultimate consumer requires some means of bridging the gap. The movement of goods and services from the place of producer through middlemen to the ultimate consumer has been thought of as a channel flow. Companies are increasingly taking a value chain network view of their businesses. Instead of limiting their focus to their immediate suppliers, distributors and customers, they are examining the whole supply chain that links raw materials, components and manufactured goods and shows how are they moved toward the final consumers. In this unit, you will learn the meaning and functions of distribution channel, the distribution channel flow, channel design decisions and the management of distribution channel. You will further study the types and causes of channel conflicts and their remedies.

13.2 CONCEPT OF DISTRIBUTION CHANNEL

A distribution channel consists of a set of people and firms involved in the transfer of title to a product as the product moves from producer to consumer. Thus, a distribution channel is primarily concerned with the movement of goods from the point of production to the point of consumption, which involves a variety of functions. The main participants in the distribution system are: (1) the manufacturers, (2) the intermediaries, (3) the facilitating agencies, and (4) the consumers. *Manufacturers* produce the goods. This is the starting point in the distribution system. The second category of participants i.e., *intermediaries*, are involved in direct negotiation between buyers and sellers whether or not they take title to goods. These intermediaries locate the manufacturers who produce various products, identify the needs of the consumers and distribute the goods. In the process, they perform various functions like buying, selling, assembling, standardization and grading, packing and packaging, risk bearing, etc. *Facilitating agencies* are the independent business organisations other than intermediaries. These agencies facilitate the smooth distribution of goods from producers, through intermediaries, to consumers. The major facilitating agencies are banking institutions, insurance companies, transportation agencies and warehousing companies. The fourth category of participants in the distribution system i.e., *consumers*, are the final destination for goods in the distribution system.

A Channel of distribution is mainly concerned with second participant i.e., the intermediaries. The term '**Channel of Distribution**' refers to the route taken by goods as they flow from the producer to the consumer. This flow of goods may mean its physical distribution and/or the transfer of title (ownership). Channels of distribution are mainly concerned with the transfer of title to a product which may be effected directly or through a chain of intermediaries. You know most producers do not sell goods directly to the consumers. They make use of a variety of intermediaries known as middlemen. These middlemen who take title to goods or assist in transferring the title to goods as they move from the producer to the consumer is called the channel of distribution. **Thus, the channel of distribution is a network of institutions that perform a variety of interrelated and coordinated functions in the movement of goods from producers to consumers.**

A distribution channel creates place, time, form and possession utilities to the products by prompt and efficient performance of the function of physical distribution. In modern societies the production of goods takes place on a large scale in factories concentrated in few localities while the consumers are scattered throughout the country. For instance, textile mills are concentrated at few places like Bombay, Ahmedabad, Coimbatore, etc., while the cloth is used by all the people in the country. Similarly, Maruti cars are manufactured at Delhi while the users are spread in all parts of the country. Same thing is true of agricultural commodities. Apples are produced mainly in Kashmir Valley and Himachal Pradesh whereas they are consumed by people throughout the country. Another such example is tea which is mainly produced in Assam while it is consumed everywhere in the country. Thus, in most of the cases goods are produced at one place while they are consumed at various other places and contact the producers directly. Similarly it is not possible for all the producers to contact the consumers directly and sell the goods. Hence, it is essential to move the goods from the place of production to the markets where consumers can buy them. Otherwise, production has no value and it becomes waste. **A distribution channel helps in the movement of goods from producer to consumer and, thus, creates place utility to the product.**

There is another barrier which arises due to time lag between production and consumption. The goods produced are not consumed at the same point of time. Some

goods are produced throughout the year, but their consumption is seasonal. For example, umbrellas and raincoats are used only during rainy season, woollen garments are used only during winter season. In some other cases, goods are produced during a specific season while they are consumed continuously throughout the year. For example, food grains are produced by farmers during a particular season but are consumed throughout the year. Thus, in many cases, there is a time lag between production and consumption. **The distribution channel makes it possible for the consumers to get the product whenever they want them and, thus, creates time utility to the products.**

Similarly, a distribution channel makes it possible for the consumers to get the products in a convenient shape, unit size, style and package. Thus, **it creates convenience value**. Distribution channel also makes it possible for the consumer to obtain goods at a price he is willing to pay and under conditions which bring him satisfaction and pride of ownership. Thus, **it creates possession utility**. Thus, it is the distribution system which moves the goods from the place of production and makes them available to the consumers at the right place, time and form.

13.3 FUNCTIONS OF DISTRIBUTION CHANNELS

Broadly, distribution channels perform the transactional functions, logistical functions and facilitating functions. Transactional functions involve buying, selling and risk bearing activities. Logistical functions involve the physical exchange of goods like assembling, storage, grading and transportation. Facilitating functions facilitate both the transaction as well as physical exchange of goods like post-purchase service and maintenance, financing, market information etc. In specific terms, distribution channel perform the following functions:

- Facilitate selling by being physically close to customers
- Provide distributional efficiency by bridging the manufacturer with the user efficiently and economically
- Break the bulk and cater to the small requirements of buyers
- Assemble products into assortments to meet buyer's needs;
- Look after a part of physical distribution/ marketing logistics
- Share the financial burden of the principal; provide deposits; finance the stocks till they are sold to the ultimate consumers; extend credit to the retailers/ consumers.
- Provide salesmanship and after-sale service
- Assist in sales promotion
- Assist in merchandising
- Assist in introducing new products
- Assist in implementing the price mechanism: assist in price negotiations
- Assist in developing sales forecasts / sales plans for the territory
- Provide market intelligence and feedback
- Maintain records
- The searching out of buyers and sellers (contacting).
- Matching goods to the requirements of market. (merchandising).
- Offering products in the form of assortments or packages of items useable or acceptable by the consumers.

- Persuading and influencing the prospective buyers to favour a certain product and its maker (personal selling/sales promotion)
- Implementing pricing strategies in such a manner that will be acceptable to the buyers and ensure effective distribution.
- Looking after all physical distribution function.
- Participating actively in the creation and establishment of the market for a new product.
- Offering pre and after sales services to the customer
- Transferring new technology to the users along with the supply of products and playing the role of change agents
- Providing feedback information, marketing intelligence and sales forecasting services for their regions to their suppliers
- Offering credit to retailers and consumers
- Risk bearing with reference to stock holding / transport.

Check Your Progress A

1. What do you mean by a channel of distribution?

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2. Enumerate five functions performed by channels of distribution.

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13.4 DISTRIBUTION CHANNELS USED

Marketing channel performs the work of moving goods from producers to consumers. It overcomes the time, space and possession gap that separates goods and services who need or want them. Members of the marketing channels perform a number of key functions which are discussed above.

Some functions (physical, title, promotion) constitute a *forward flow* of activity from the company to the customer; other functions (ordering and payment) constitute a *backward flow* from customer to the company. Still others (information, negotiations, finance and risk taking) occur in both directions. Look at Figure 13.1 which illustrates the marketing of trucks. A manufacturer selling a physical product and services might require three channels: sales channel, delivery channel and a service channel.

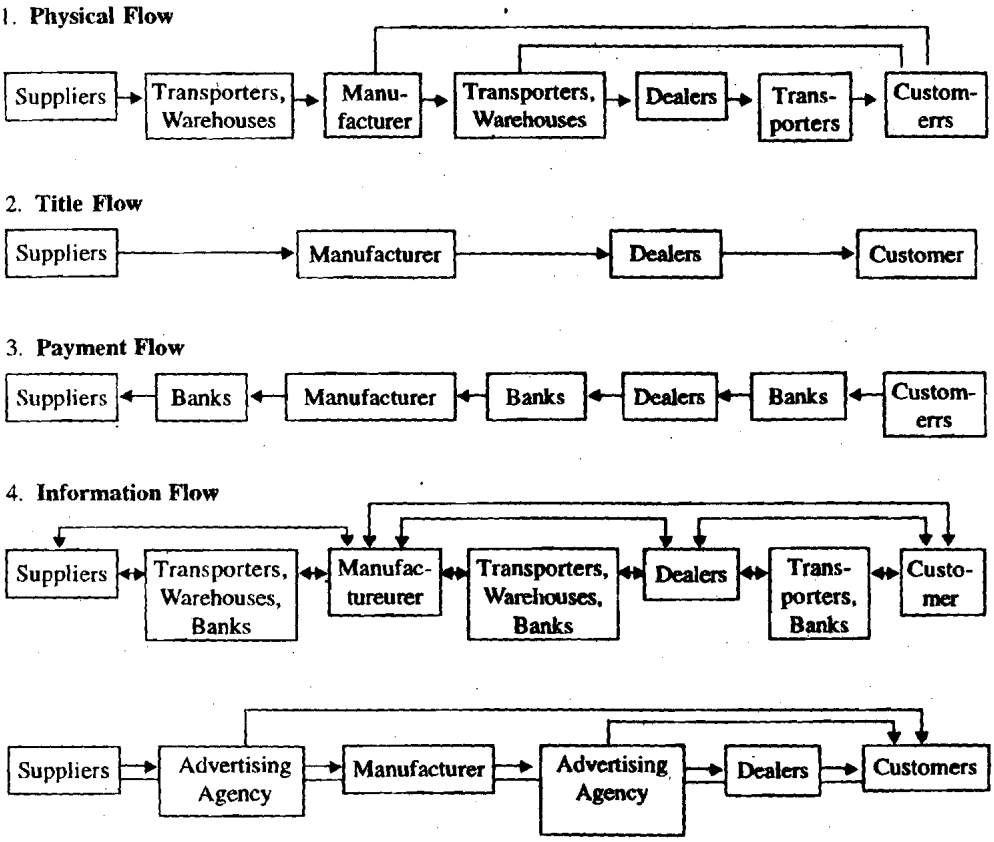

Figure 13.1: Five Marketing Flows in the Marketing Channels for Trucks

Channel Levels: The producer and the final customer are the part of every channel. The number of intermediary levels is used to designate the length of the channels.

A **zero level channel** (also called *direct marketing channel*) consists of manufacturer selling directly to the final customer. The major examples are door-to door sales, home parties, mail order, tele marketing, T.V. selling; internet selling and manufacture own stores. Avon sales representatives sells cosmetics door- to – door. Tupperware representatives sells kitchenware goods through home parties.

A **one level channel** contains one selling intermediary, such as a retailer. A **two level channel** contains two intermediaries. In consumer markets, these are typically a wholesaler and a retailer. A **three level channel** contain three intermediaries. In the meat packing industry wholesaler sell to jobber who sell to small retailer. Longer marketing channels consisting of more than three levels can also be found. In Japan, food distribution may involve as many as six levels. From the producer's point of view, obtaining information about end users and exercising control become more difficult as the number of channel level increases.

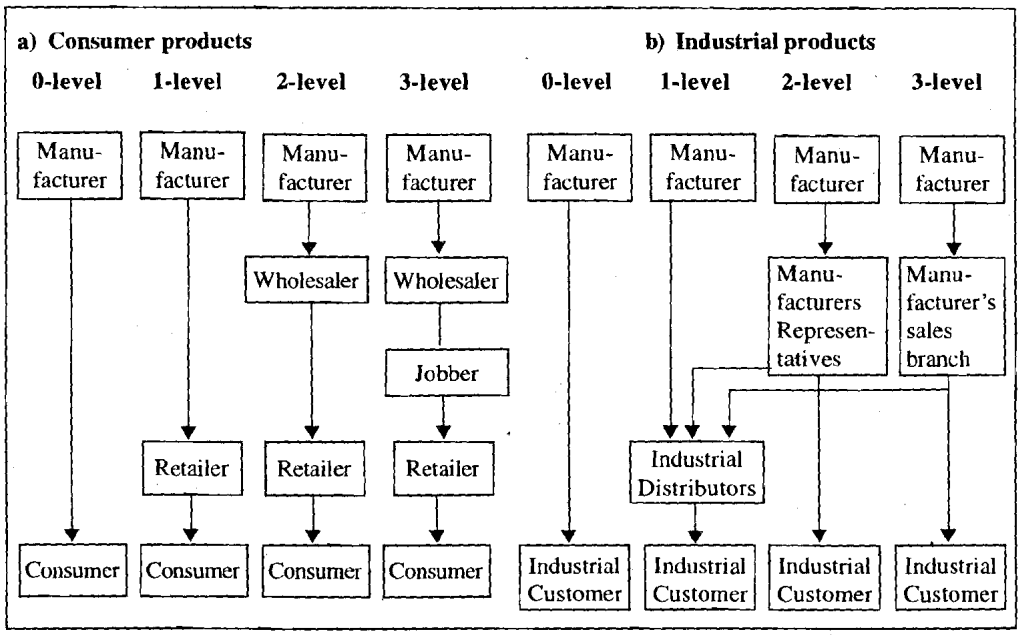

Figure 13.2: Marketing Channels for Consumers and Industrial Products

Channels for Consumer Products

These channels are used for consumer durable goods which are directly consumed by the household. For example, TV, car, food items etc. Following levels of channel are used for this purpose.

- **Producer ⟶consumer.** The shortest, simplest distribution channel for consumer goods involves no middlemen. The producer may sell door to door or by mail. For instance, Southwestern Company uses college students to market its books on a door to door basis.
- **Producer⟶retailer ⟶consumer.** Many large retailers buy directly from manufacturers and agricultural producers. To the chagrin of various wholesaling middlemen, Wal-Mart has increased its direct dealings with producers.
- **Producer wholesaler⟶ retailer ⟶ consumer.** If there is a traditional channel for consumer goods, this is it. Small retailers and manufacturers find these channels the only economically feasible choice.
- **Producer⟶agent ⟶retailer ⟶consumer.** Instead of using wholesalers, many producers prefer to use agent middlemen to reach the retail market, especially large scale retailers. For example, Clorox uses agent middlemen (such as Eisenhart &Associates, a food broker) to reach retailers (such as Dillon's and Schnucks, both large grocery chains), which in turn sell Clorox's cleansing products to consumers.
- **Producer⟶agent ⟶wholesaler ⟶ retailer⟶ consumer.** To reach small retailers producers often use agent middlemen, who in turn call on wholesalers that sell to large retail chains and/or small retail stores. Working as an agent on behalf of various groceries -products **manufacturer**, Eisenhart & Associates sells to some wholesalers (such as Super Value) that distributes a wide range of product to retailers (such as Dierberg's, a supermarket chain at St. Louis area). In turn Die bergs offer its assortment of product to final consumers.

Channels for Industrial Products

A variety of channels are available to reach organizations that incorporate the products into their manufacturing process or use them in their operations. In the

distribution of business goods, the terms *industrial distributor* and *merchant wholesaler* are synonymous. The four common channels for business goods are:

- **Producer ⟶ user.** The direct channel accounts for a greater *dollar* volume of business products than any other distribution structure. Manufacturers of large installations, such as airplanes generator, and heating plants usually sell directly to users.
- **Producer ⟶ industrial distributor ⟶ user.** Producers of operating supplies and small accessory equipment frequently use industrial distributors to reach their markets. Manufacturers of building materials and air-conditioning equipment are two examples of firms that make heavy use of industrial distributors.
- **Producer ⟶ agent ⟶ user.** Firms without their own sales department find this a desirable channel. Also a company that wants to introduce a new product or enter a new market may prefer to use agents rather than its own sales force.
- **Producer ⟶ agents ⟶ industrial distributor ⟶ user.** This channel is similar to the preceding one. It is used when, for some reason, it is not feasible to sell through agents directly to the business user. The unit sale may be too small for the direct selling. Or decentralized inventory may be required to supply users rapidly, in which case the storage services of an industrial distributor may be required.

Distribution Channels for Services

The intangible nature of services creates special distribution requirements. There are only two common channels for services.

- **Producer ⟶ consumer**. Because a service is intangible, the production process and/or sales activity often require personal contact between producer and consumer. Thus a direct channel is used. Direct distribution is typical for many professional services, such as healthcare and legal and personal services, such as hair cutting and weight-loss counselling. However, other services including travel, insurance and entertainment, may also rely on direct distribution.
- **Producer ⟶ agent ⟶ consumer.** While direct distribution often is necessary for a service to be performed, producer –consumer contact may not be required for distribution activities. Agents frequently assist a service producer with transfer of ownership (the sales task) or related tasks. Many services notably travel, lodging, advertising media, entertainment and insurance, are sold through agents.

13.5 FACTORS INFLUENCING THE CHOICE OF CHANNEL

We have learnt that there are a number of channels used for distributing the goods. There are direct channels and indirect channels, short channels as well as long channels. We also learnt that the different channels are used for different types of products. When there are alternative channels available, the selection of an appropriate channel becomes a very important decision for the producers. The choice of a channel for distribution of any product should be such that it should effectively meet the needs of customers in different markets at reasonable cost. The factors which generally influence the choice of the channel of distribution may be categorised under four groups as follows:

1) Market considerations
2) Product considerations

3) Middlemen considerations
4) Company considerations

Let us discuss them in detail.

Product Considerations

1) **Perishability:** The nature of the product influences the choice of channel. Perishable products like eggs, milk, etc., are supplied either directly or through the short channels. If long channels are opted for perishable goods, they may get spoiled by the time they reach the consumer. So products which are perishable must be speeded through the short channels.

2) **Bulkiness:** In the case of heavy and bulky products (e.g., cement, steel, heavy machinery, etc.) where distribution and handling costs are more, short channels are preferred. On the other hand, long channels are found in the case of light-weight and small-size items like dress material, readymade garments, pocket calculators, stationery, toothpaste, toothbrush, etc.

3) **Technical nature of the product:** Sophisticated electrical and electronics equipment which require careful handling are also generally distributed directly or through short channels. In the case of sophisticated equipment like computers and xerox machines, considerable amount of presale and postsale service is required, Wholesalers and retailers may not be able to provide such services. So manufacturers often distribute them directly. However, simple mechanical products like electronic toys, time-clocks, etc., are supplied through long channels for intensive distribution.

4) **Product value:** Unit value of the product is also an important consideration while deciding the channel of distribution. Normally larger channels are preferred for products whose unit value is low. However, short channels may be equally economical when such products are sold in bulk or are combined with other products. .

Market Considerations

1) **Size of the customers:** It is possible in the case of fewer customers purchasing large quantities at regular intervals and if they are concentrated in a small area.

2) **Potential volume of sales:** The choice of channel depends upon the target volume of business. The ability to reach target customers and the volume of sales varies between different channels. If one outlet is not adequate for achieving the target, more channels need to be used. Of course, the competitive situation must be taken into account while examining the potential volume of sale through different channels.

3) **Concentration of buyers:** If the buyers are concentrated in a few areas, it is possible for the manufacturer to establish sales divisions in such areas and sell directly to the buyers. Thus, short channels may be feasible when buyers are concentrated in fewer locations. On the other hand, if buyers are spread over a large geographic area, short channels may become uneconomical and the manufacturer may have to go for long and multiple channels.

4) **Size of the purchase order:** Manufacturer can distribute directly or through a short channel in the case of large scale buyers. Normally long channels are effective and economical in the case of buyers whose purchase orders are usually too small to justify direct sale.

Middlemen Considerations

1) **Types of middlemen:** Availability of suitable middlemen in the channel of distribution is another factor in the selection of the channel. This is because different functions like standardisation, grading, packing, branding, storage, after-sale servicing, etc., are expected to be performed by middlemen. Efficiency of distribution depends upon the size, location and financial position of middlemen. If the middlemen in a specific channel are dependable and efficient, that channel may be preferred by producers.

2) **Channel competition:** There are different situations in which manufacturers compete with each other for availing the services of particular wholesalers. Similarly, wholesalers often compete with each other to deal with particular retailers or carrying particular brands of products. Sometimes producers use the same channel which is used by their competing producers. If any producer arranges exclusive distribution through a particular wholesaler, the other producers also do the same. Thus selection of a channel may depend on the competition prevailing in the distribution system.

3) **Availability of middlemen:** The producer may wish to make use of the services of specific category of middlemen, but such middlemen may not be available in the market. They may be carrying the competitors' products and may not wish to add another product line. In such situations, the manufacturer has to make use of the services of the middlemen whoever available in the market.

Company Considerations

1) **Cost of distribution:** The various functions carried out in the channel of distribution add to the cost of distribution. While choosing a channel, the distribution costs of each channel should be calculated and its impact on the consumer price should be analysed. A channel which is less expensive is normally preferred. Sometimes, a channel which is convenient to the customers is preferred even if it is more expensive. In such cases the choice is based on the convenience of the customers rather than the cost of distribution.

2) **Long-run effect on profit:** Direct distribution, short channels, and long channels have different implications with regard to the profits in the short-run and long-run. If demand for a product is high, reaching the maximum number of customers through more than one' channel may be profitable. But the demand may decline in course of time as competing products appear in the market. It may not be economical than to use long channels. So while choosing a channel one should keep in mind the future market implications as well.

3) **Experience and ability:** A manufacturer who has reasonable experience and expertise in marketing the products may prefer to distribute his products on his own. But the manufacturers who do not have marketing know-how prefer to make use of the services of middlemen.

4) **Financial strength:** Lots of financial resources are required to establish distribution system. So only a financially strong manufacturer can establish his own distribution system and a financially weak firm may have to depend on middlemen.

5) **Extent of channel control:** Producers who want good control over the distribution of their products prefer short channels. Controlling of the channels is necessary to undertake aggressive promotion, to maintain fresh stocks and retail prices.

Thus, in making a choice, the manufacturer has to consider his objectives, resources and the channels available to him, nature of the product and characteristics of the

buyers. He would like to use the channel of distribution which will produce the combination of sales volume and cost that yields him the maximum amount of profit. There are no set guidelines for channel selection and the manufacturer will have to make his own decision in the light of his own judgment and experience. However, most companies do use multiple channels of distribution to ensure that their products reach the maximum number of people.

The task of manufacturer does not end after the channels have been selected. He has to review the services performed by the agencies involved at fairly frequent intervals, keep in close touch with the developments related to the distribution of his product and seek to improve his marketing methods constantly. He may also realise that the best channel when the product was introduced, may not be the most effective one when the product is established. The following criteria may be used for the evaluation of channel members: 1) their sales performance, (ii) their marketing capabilities, (iii) their motivation to increase the volume of sales, (iv) competition faced by them, and (v) their growth prospects.

13.6 CHANNEL DESIGN DECISIONS

A new firm typically starts as a local operation selling in a limited market, using existing intermediaries. The number of intermediaries in any local market is apt to be limited: a few manufacturers' sales agents, a few wholesalers, several established retailers, a few trucking companies and a few warehouses. Deciding on the best channels might not be a problem. The problem might be to convince the available intermediaries to handle the firm's line. If the firm is successful, it might branch into new markets. It might have to use different channels in different markets. In smaller markets, the firm might sell directly to retailers; in larger markets, it might sell through distributors. In rural areas, it might work with general goods merchants; in urban areas, with limited line merchants in one part of the country, it might run exclusive franchisees; in another, it might sell through all outlets willing to handle the merchandise. In one country it might use international sales agents; in another, it might partner with a local firm. In short, the channel system evolves in response to local opportunities and conditions.

In managing its intermediaries, the firm must decide how much effort to devote to push versus pull marketing. A **push strategy** involves the manufacturer using its sales force and trade promotion money to induce intermediaries to carry, promote, and sell the product to end users. Push strategy is appropriate where there is low brand loyalty in a category, brand choice is made in the store, the product is an impulse item and product benefits are well understood. A **pull strategy** involves a manufacturer using advertising and promotion to induce consumers to ask intermediaries for the product, thus inducing the intermediaries to order it. Pull strategy is appropriate when there is high brand loyalty and high involvement in category, when people perceive differences between brands, and when people choose the brand before they go to the store.

Designing a channel system involves five steps. Let us learn them in detail.

1. Analyze Customers' Desired Service Output Levels

In designing the marketing channel, the marketer must understand the service output levels desired by target customers. Channels produce five service outputs. They are as follow:

- *Lot Size:* The number of units the channel permits a typical customer to purchase on one occasion. In buying cars for its fleet, Hertz prefers a channel from which it can buy a large lot size; a household wants a channel that permits buying a lot size of one.

- ***Waiting Time:*** The average time customers of that channel wait for the receipt of the goods customers normally prefer fast delivery channels.
- ***Spatial Convenience:*** The degree to which the marketing channel makes it easy for customers to purchase the product. Chevrolet offers greater spatial convenience than Cadillac because there are more Chevrolet dealers. Chevrolet's greater market decentralization helps customers save on transportation and such cost in buying and repairing an automobile.
- ***Product Variety:*** The assortment breadth provided by the marketing channel. Normally customers prefer a greater assortment because more choices increase the chance of finding what they need.
- ***Service Backup:*** The add-on services (credit, delivery, installation, repairs) provided by the channel. The greater the service backup, the greater the work provided by the channel.

The marketing-channel designer knows that providing greater service outputs means increased channel costs and higher prices for customers. The success of discount stores indicates that many consumers are willing to accept smaller service outputs if they can save money.

2. Establish Objectives and Constraints

Effective planning requires determining which market segments to serve and the best channels to use in each case. Channel objectives vary with product characteristics. Perishable products require more direct marketing. Bulky products such as building materials require channel that minimize the shipping distance and amount of handling. Non standardized products, such as custom built machinery and specialized business forms are sold directly by company sales representatives. Products requiring installation or maintenance such as heating and cooling system are usually sold and maintained by the company or by franchise dealers. High unit value products such as generators and turbines are often sold through a company sales force rather than intermediaries. Channel design must take into account the strengths and the weaknesses of different types of intermediaries for e.g. manufacturers' reps. are able to contact customers at a low cost per customer because the total cost is shared by several clients, but the selling effort per customer is less intense than if company sales representatives did the selling. Channel design is also influenced by competitor's channels. Channel designs must adapt to the larger environment when economic conditions are depressed, producer want to move their goods to market using shorter channels and without services that add to the final price of the goods. Legal regulations and restrictions also affect channel design.

3. Identify Major Channel Alternatives

Companies can choose from a wide variety of channels for reaching customers – from sales force to agents, distributors, dealers, direct mail, telemarketing and the internet. Each channel has unique strengths and weaknesses. Sales forces can handle complex products and transactions, but they are expensive. The Internet is much less expensive. But it cannot handle complex products. Distributor can create sales but the company loses direct contact with customers. The problem is further complicated by the fact that most companies now use a mix of channels. Each channel hopefully reaches a different segment of buyers and delivers\s the right products to reach at the least cost when this does not happen; there is usually channel conflict and excessive cost. A channel alternative is described by three elements:

- The types of available business intermediaries
- The number of intermediaries needed
- Terms and responsibilities of each channel members

A firm needs to identify the types of intermediaries available to carry on its channel work. A company should search for innovative marketing channels. The Conn Organ company merchandises organs through department stores and discount stores, thus drawing more attention than it ever enjoyed in small music stores. The Book-of -the – Month club merchandises mail through the mail. Other sellers have followed with the Record-of-the-Month clubs, Candy-of-the-month clubs and dozen of others.

Sometimes a company chooses an unconventional channel because of the difficulty or cost of working with the dominant channel. The advantage is that the company will encounter less competition during the initial move into this channel. After trying to sell its inexpensive Timex watches through regular jewellery stores the U.S. Time Company placed its watches in fast growing mass mechanized outlets. Avon chose door-to-door selling because it was not able to break into regular department stores and has thus proved to be a great success.

Companies have to decide on the number of intermediaries at each channel levels. Three strategies may be adopted for this purpose. They are discussed below.

Exclusive Distribution: It means severely limiting the number of intermediaries. It is used when the producer wants to maintain control over the service level and outputs offered by the resellers. By granting exclusive distribution the producer hopes to obtain more dedicated and knowledgeable selling. It is mainly seen in case of distribution of new automobiles, some major appliances and some women's apparel brands. Relationship with intermediaries and the corporation can be strained when a company decides to alter an exclusive distribution relationship.

Selective Distribution: It involves the use of more than a few but less than all of the intermediaries who are willing to carry a particular product. It is used by established companies and new companies seeking distributors. The company does not have to worry about too many outlets; it can gain adequate market coverage with more control and less cost than intensive distribution. Disney sells its videos through five different channels: Movie rental stores like Blockbuster; the company's proprietary retail stores, called Disney Stores; retail stores like Best Buy; online retailers like Amazon.com and Disney's own online Disney Stores; the Disney catalog and other catalog sellers. These varied channels afford Disney maximum market coverage, and enable the company to offer its videos at a number of price points.

Intensive Distribution: It consists of manufacturer placing the goods or services in as many outlets as possible. This strategy is generally used for item such as tobacco products, soap, snack foods, and gum, products for which the consumer requires a great deal of location convenience.

Manufacturers are constantly tempted to move from exclusive or selective distribution to intensive distribution to increase coverage and sales.

4. Determine Terms and Responsibilities of Channel Members

The producer must determine the rights and responsibilities of participating channel members. Each channel member must be treated respectfully and given the responsibility to be profitable. The elements in the 'trade-relation mix' are:

- price policies,
- conditions of sale,
- territorial rights, and
- Specific services to be performed by each part.

Let us discuss them in detail.

Price policy calls for the producer to establish a price list and schedule of discounts and allowances that intermediaries see as equitable and sufficient.

Conditions of sale refer to payment terms and producer guarantees. Most producers grant cash discounts to distributors for early payment. Producers must also guarantee distributors against defective merchandise or price declines. A guarantee against price declines give distributors an incentive to buy larger quantities.

Distributors' territorial rights define the distributors territories and the terms under which the producer will enfranchise other distributors normally expect to receive full credit for all sales in their territory whether or not they did the selling.

Mutual services and responsibilities must be carefully spelled out especially in franchise and exclusive agency channels. Mc Donald's provides franchisee with a building, promotional support, record keeping system, training, and general administrative and technical assistance. In turn franchisees are expected to satisfy company standards regarding physical facilities cooperate with new promotional programmes, furnish requested informations, and buy supplies from specified vendors.

5. Evaluate the Major Alternatives

Each channel alternative needs to be evaluated against economic control and adaptive criteria.

Economic Criteria: Each channel alternative will produce a different level of sales and costs.

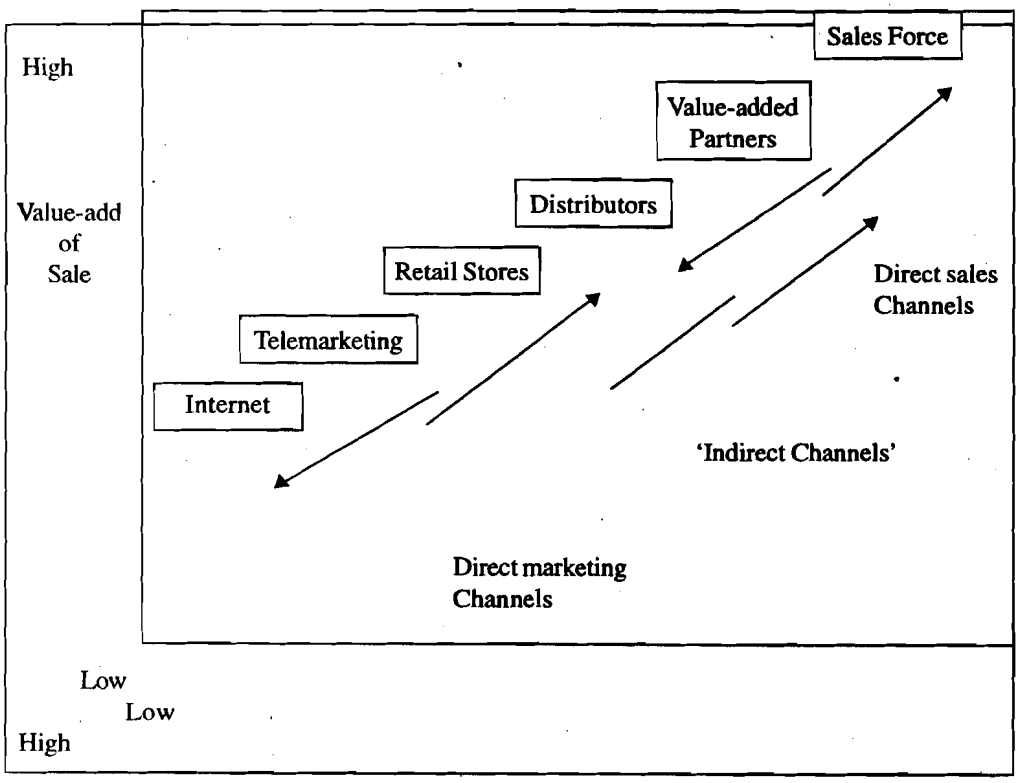

Figure 13.3: The Value-Adds Versus Cost of Different Channels

Look at Figure 13.3 which shows how six different sales channels stack up in terms of the value added presale and the cost per transaction. For e.g., in selling industrial products costing between$2000 NAD$5000 the cost per transaction is $500(field sales), $200(distributors), $50(telesales), and $10 (Internet). Banks claim that in selling retail banking services, the cost per transaction is $2(teller), $.50(ATM), and $ .10 (internet). Clearly, sellers would try to replace high cost channel with low cost channel when the value added per sale was sufficient. When sellers discover convenient a lower cost channel, they try to get the customers to use it. The company may reward customers for switching SAS; the Scandinavian Airlines gave bonus points to

customer who ordered electronic tickets via the internet. Other companies may raise the fees on customers using the high cost channel to get them to switch. Companies that are successful in switching their customers to lower cost channels, assuming no loss of sales or deterioration in service quality, will gain a channel advantage.

The lower-cost channel tends to be low-touch channel. This is not important in ordering commodity items, but buyers who are shopping for more complex products prefer high- touch channel such as sales people.

Control and Adaptive Criteria: Using a sales agency poses a control problem a sales agency is an independent firm seeking to maximize its profits. Agents may concentrate on the customers who buy the most not necessarily those who buy the manufacturer's goods. Further more agents might not master the technical detail of the company's product or handle its promotional materials effectively.

To develop a channel, members must make some degree of commitment to each other for a specific period of time. Yet these commitments invariably lead to a decrease in the producer's ability to respond to a changing market place. In rapidly changing volatile or uncertain products' market producers need channel structures and policies that provide high adaptability.

Check Your Progress B

1. Enumerate five factors which influence the choice of a consumer durable product.

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2. Make a diagramme of consumer marketing channel and give examples of two products which follow such channel.

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3. Make a diagramme of industrial marketing channel and give examples of two products which follow such channel.

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4. Distinguish between selective and intensive distribution.

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13.7 CHANNEL MANAGEMENT

After a company has chosen a channel alternative, individual intermediaries must be selected, trained, motivated, and evaluated. Channel arrangements must be modified over time. Following activities are undertaken in the management of channel.

1. **Selecting Channel Members:** Companies need to select their channel members carefully. To customers the channels are the company. Consider the negative impression the customer would get of Mc. Donald's Shell Oil, or Ford if one or more of their outlets or dealers consistently appeared dirty inefficient or unpleasant.

   Producers vary in their ability to attract qualified intermediaries. Toyota was able to attract many new dealers for its new Lexus. However, when Polaroid started up as a company it could not get camera stores to carry its new camera and was forced to use mass- merchandising outlets.

   Whether producers find it easy or difficult to recruit intermediaries they should at least determine what characteristics distinguish the better intermediaries. They should evaluate the number of years in business, other lines carry, growth and profit record, financial strength, cooperativeness, and service reputation. If the intermediaries are sales agents, producers should evaluate the number and character of other lines carried and the size and quality of the sales force. If the intermediaries are department stores that want exclusive distribution, the producers should evaluate locations, further growth potential and type of clientele.

2. **Training Channel Members:** Companies need to plan and implement careful training programmes for the intermediaries because they will be viewed as the company by end users. Microsoft requires third party engineers to complete a set of courses and take certification exams. Those who pass are formally recognized as Microsoft Certified Professionals and they can use this designation to promote business.

3. **Motivating Channel Members:** A company needs to view intermediaries in the same way it views its end users. It needs to determine needs and construct a channel positioning such that its channel offering is tailored to provide superior value to these intermediaries the company should provide training programmes to improve intermediaries' performance. The company must constantly communicate its view that the intermediaries are partners in a joint effort to satisfy end users of the product.

   Stimulating channel members to top performance starts with understanding their needs and wants. Philip Mc. Vey listed the following propositions to help understand intermediaries (the intermediaries often acts) as a purchasing agents for his customers and only secondarily as a selling agent for his supplier....he is interested in selling any product which these customers desire to buy from him.

   The (intermediary) attempts to weld all of his offerings into a family of items which he can sell in combination, as a packet assortment to individual customers. His selling efforts are directed primarily at obtaining orders for the assortment rather than for individual items.

   Unless given initiative to do so (intermediaries) will not maintain separate sales record by brand sold. The information that could be used in product development, pricing, packaging or promotion planning is buried in non standard records of intermediaries, and sometimes purposely secreted from suppliers.

Producers are very keen in managing distributors. They can draw on the following types of power to elicit cooperation:

- ***Coercive power:*** A manufacturer threatens to withdraw a resource or terminate a relationship if intermediaries fail to cooperate. This power can be effective, but its exercise produces resentment and can lead the intermediaries to organize countervailing power.
- ***Reward power:*** The manufacturer offers intermediaries an extra benefit for performing specific acts or functions. Reward power typically produces better results than coercive power but can be overrated. The intermediaries may come to expect a reward every time the manufacturer wants a certain behaviour to occur.
- ***Legitimate power:*** The manufacturer requests a behaviour that is warranted under the contract. As long as the intermediaries view the manufacturer as a legitimate leader, legitimate power works.
- ***Expert power:*** The manufacturer has special knowledge that the intermediaries value. Once the expertise is passed to the intermediaries, however, this power weakens. The manufacturer must continue to develop new expertise so that the intermediaries will want to continue cooperating.
- ***Referent power:*** The manufacturer is so highly respected that the intermediaries are proud to be associated with it. Companies such as IBM, Caterpillar, Hewlett /Packard have high referent power.

Intermediaries can aim for a relationship based on cooperation, partnership, or distribution programming. Most producers see the main challenge as gaining intermediaries cooperation. They often use positive motivators, such as high margins, special deals, premiums, cooperative advertising allowances, display allowances, and sales contests. At times they will apply negative sanctions such as threatening to reduce margins, slow down delivery, or terminate the relationship. The weakness of this approach is that the producer is using crude, stimulus-response thinking.

More sophisticated companies try to forge a long term partnership with distributors. The manufacturers clearly communicates what it wants from its distributors in the way of market coverage, inventory levels, marketing development, account solicitation, technical advice and services and marketing information. The manufacturer seeks distributor's agreement on these policies and may introduce a compensation plan for adhering to these policies.

4. **Evaluating Channel Members:** Producers must evaluate intermediaries' performance periodically against such standards as sales quota attainment, average inventory levels, customary delivery time, treatment of damaged and lost goods, and cooperation in promotional and training programmes. A producer will occasionally discover that it is paying too much to intermediaries for what they are actually doing. Producers should set up functional discounts in which they pay specified amounts for the trade channel's performance of each agreed upon service. Underperformers need to be counselled, retrained, remotivate or terminated.
5. **Modifying Channel Arrangements:** Producer must review and modify its channel arrangements periodically. Modification becomes necessary when the distribution channel is not working as planned, consumer buying pattern change, the market expands, new competition arises, innovative distribution channels emerge, and the product moves into later stages in the product life cycle. No marketing channel will remain effective over the whole product life cycle. Early buyers may be willing to pay for high value added channels, but later buyers will switch to lower – cost channels. Small office copiers were first sold by manufacturer's direct sales forces, later through office equipment dealers, still later through mass merchandisers, and now by mail order firms and Internet marketers.

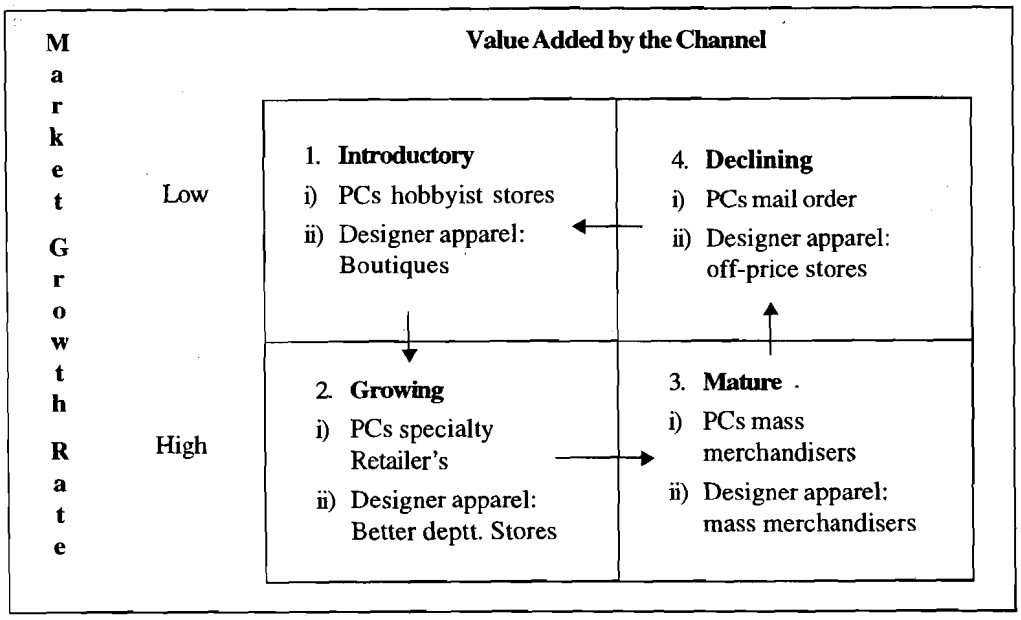

Figure 13.4: Channel Value Added and Market Growth Rate

Look at Figure 13.4 which shows the grid developed by Midland Lele. The grid shows how marketing channels have changed for PCs and designer apparel at different stages in the product life cycle:

- ***Introductory stage:*** Radically new products or fashions tend to enter the market through specialist channels (such as boutiques) that spot trends and attract early adopters.
- ***Rapid growth stage:*** As interest grows, higher-volume channels appear (dedicated chains, department stores) that offers services but not as many as the previous channels.
- ***Maturity stage:*** As growth slows, some competitors move their product into lower-cost channels (mass merchandisers).
- ***Decline stage:*** As decline stage begins, even lower –cost channels emerge (mail order houses, office price discounters).

In competitive markets with lower entry barriers, the optimal channel structure will inevitably change over time. The change would involve adding or dropping individual channel members, adding or dropping particular market channels, or developing a totally new way to sell goods.

Adding or dropping individual channel members require an incremental analysis. What would the firm's profits look like with and without this intermediary? An automobile manufacture's decision to drop a dealer requires subtracting a dealer's sales and estimating the possible sales loss or gain to the manufacturers' other dealers.

The most difficult decision involves revising the overall channel strategy. Distribution channel clearly becomes outmoded, and a gap arises between the existing distribution system and the ideal system that would satisfy target customers' needs and desires.

13.8 CHANNEL CONFLICTS

No matter how well channels are designed and managed, there will be some conflict, if for no other reasons than the interest of independent business entities do not always coincide. Here we examine three questions:

- What type of conflict arises in channels?
- What causes channel conflict?
- What can be done to resolve conflict situation?

13.8.1 Types of Channel Conflicts

Suppose a manufacturer sets up a vertical channel consisting of wholesalers and retailers. The manufacturer hopes for channel cooperation that will produce great profits for each channel members. Yet vertical, horizontal and multi-channel can occur.

Vertical Channel Conflict means conflict between different levels within the same channels. General Motors came into conflict with its dealer in trying to enforce policies on service, pricing, and advertising. Coca-Cola came into conflict with bottlers who also agreed to bottler Dr. Pepper.

Horizontal Channel Conflict involves conflict between members at the same level within the channel. Some Ford car dealers in Chicago complain about other Chicago Ford dealers advertising and pricing too aggressively. Some Pizza Inn franchisees complained about other Pizza Inn franchisees cheating on ingredients, providing poor service, and hurting the overall Pizza Inn image.

Multichannel Conflicts exist when the manufacturer has established two or more channels that sell the same market. When Levi Strauss agreed to distribute its jeans through Sears and JC Penny in addition to its normal specialty store channel, the specialty stores complained. When clothing manufacturers like Ralph Lauren and Anne Clein opened their own stores the department stores that carried their brands were upset. When Goodyear began selling its popular tyre brands through Sears, Wall-Mart , and Discount Tire, it angered its independent dealers.(it eventually placated them by offering exclusive tyre models that would not be sold in other retail outlets.) Multichannel conflict is likely to be especially intense when members of one channel get a lower price (based on large volume purchasers) or worked with a lower margin. One of the major current examples of multichannel conflict is brick-and- mortar companies sweating over whether to add and online e-commerce channel. Vans & Nobel, Merrill Lynch, Compaq, and All State Insurance all resisted but eventually succumbed after seeing how much online business was rushing to its competitors, Amazon, e-trade, Dell and Direct Line, respectively. Yet adding an e-commerce channel creates a threat of a backlash from the retailers, brokers, agents, and other intermediaries. For example retailers were angered when Mattel decided to sell Barbie via the Internet. The question is how to sell both through intermediaries and online. There are at least three strategies for trying to gain acceptance from intermediaries. One offer different brands or products on the Internet. Two, offer the offline partners higher commissions to cushion the negative impact on sales. Three, take orders on the website but have retailers deliver and collect payments.

Here are some companies that have reconciled their offline and online marketing channels.

- **Talbot**, a special women's clothing chain runs out of an item the sales clerk will order it at Talbot's' catalog call centre. Customers pay a flat $4shippin charge , which is less than the normal charge or regular catalog orders. The store earns credit of the catalog sale.
- **Liberty Mutual,** asked its online customer if they might prefer to work through a financial adviser; if yes, their information will be routed to and advisor.
- **Avon** showed its reps. that its online sales will not overlap with the sales from existing customers and offered to help reps. Set up their own Website.

- **Japans** offers online coupons that can be printed and redeemed in its stores, and May even sell some items online that are not profitable to sell through its stores.
- **Gibson Guitars** started by selling accessories such as guitar strings and parts online and is eager to overcome dealers 'objection to selling guitars over the Internet. It may have to give some credit to the guitar store nearest the customer who bought online.

Ultimately the companies may need to decide whether to drop some or all of the retailers and go direct.

Given the superiority of Internet based ordering, what is to stop an auto company customers the ability to design a car on the Website and have it assembled and delivered to the customers premises within a week? The cost of operating ***virtual dealership*** would be considerably less than the present dealership systems, where cars sit in inventory for seventy days and companies have to spend about 10% of the cars' price on ads and promotions to get customers to buy. Our predictions are that more companies in the economy will shift from build-for –stock to build- to- order.

13.8.2 Causes of Channel Conflict

It s important to identify the causes of channel conflict. Some are easy to resolve, others are not. One major cause is *goal incompatibility*. For example, the manufacturer may want to achieve rapid market penetration through a low- price policy. Dealer, in contrast, may prefer to work with high margins and persuade short-run profitability. Sometimes conflict arises from *unclear roles and rights* . IBM sells personal computers to large accounts through its own sales force, and its licence dealer is also trying to sell to large accounts. Territory boundaries and credit for sales often produce conflict.

By adding new channels, a company faces the possibility of a channel conflict. The following three channel conflict arose at IBM:

- ***Conflict between the national accounts managers and the field's sales force:*** National account managers only rely on field sales people to make calls at certain national account customers located in the sales person territory, sometimes on a moments notice. Request from several national account managers to make such calls can seriously disrupt the sales person's normal schedule and hurt commissions. Sales people may not cooperate with national account managers when doing so conflict with their own interest.
- ***Conflict between the field sales force and the telemarketers:*** Sales people often resent the company's setting up a telemarketing operation to sell to smaller customers. The company tells the salespeople that telemarketers free up their time to sell to larger accounts on which they can earn more commissions, but the sales people still object.
- ***Conflict between the field sales force and the dealers:*** Dealers include value-added resellers, who buy computers from IBM and add specialized software needed the target buyer, and computer retail stores , which are an excellent channel for selling small equipment to walk –in traffic and small business. These dealers frequently offer specialized software installation and training, better service and even lower prices than IBM's direct sales force. The direct sales force becomes angry when these dealers go after large accounts: they want IBM to refuse to sell through dealers who try to sell to large accounts, but IBM would lose a lot of business if it dropped these successful resellers. As an alternative IBM decided to give partial credit to salespeople for business sold to their accounts by aggressive resellers.

Conflicts can also stem from *differences in perception*. The manufacturer may be

optimistic about the short-term economic outlook and want to carry higher inventory. Dealers may be pessimistic. Conflict may also arise because of the intermediaries' *dependence* on the manufacturer. The fortunes of exclusive dealers, such as auto dealers, are profoundly affected by the manufacturers' product and pricing decisions. The situation creates a high potential for conflict.

13.8.3 Managing Channel Conflict

Some channel conflict can be constructive and lead to more dynamic adoption to a changing environment, but too much is dysfunctional. The challenge is not to eliminate conflict but to manage it better. There are several mechanisms for effective conflict management.

One is the adoption of super ordinate goals. Channel members come to an agreement on the fundamental goal they are jointly seeking, whether it is survival, market share, high quality or customer satisfaction. They usually do this when the channel faces an outside threat, such as a more efficient competing channel, an adverse piece of legislation, or a shift in consumer desires.

A useful step is to exchange persons between two or more channel levels. General Motors executive might agree to work for a short time in some dealerships, and some dealership owners might work in GMs dealer policy department. Hopefully the participants will grow to appreciate the others point of view.

Co-optation is an effort by one organization to win the support of the leaders of another organization by including them in advisory councils, boards of directors, and the like. As long as the initiating organization treats the leaders seriously and listens to their opinions, co-optation can reduce conflict, but the initiating organization may have to compromise its policies and plans to win support.

Much can be accomplished by encouraging joint membership in and between trade associations .For example there is good cooperation between the Grocery Manufacturers in America and the Food Marketing Institute, which represents most of the food chains ; this cooperation led to the development of Universal Product Code (UPC). Presumably the associations can consider issues between food manufacturers and retailers and resolve them in an orderly way.

When conflict is chronic or acute, the parties may have to resort to diplomacy, mediation, or arbitration. ***Diplomacy*** takes place when each side sends a person or group to meet with its counterpart to resolve the conflict. ***Mediation*** means resorting to a neutral third party who is skilled in conciliating the two parties' interests. ***Arbitration*** occurs when the two parties agree to present their arguments to one or more arbitrators and accept the arbitration decision. Sometimes, when none of these methods prove effective, a company or a channel partner may chose to file a lawsuit.

Check Your Progress C

1. Distinguish between coercive power and reward power.

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2. What is channel conflict?

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3. Enumerate three causes of channel conflict.

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13.9 LET US SUM UP

A distribution channel is a set of people and firms involved in the flow of title to a product as it moves from producer to ultimate consumer or business user. A channel includes producer, final customer and any middlemen that participate in the process. Distribution channels perform the transactional functions, logistical functions and facilitating functions.

Designing a channel of distribution for a product occurs through a sequence of four decisions:

- Delineating the role of distribution within the marketing mix
- Selecting the proper type of distribution channel
- Determining the appropriate intensity of distribution
- Choosing specific channel members

A variety of channels are used to distribute consumer goods, business goods and services. Firms often employ multiple channels to achieve broad market coverage although this strategy can alienate some middleman.

Numerous factors need to be considered in selecting a distribution channel. The primary consideration is the nature of the target market. Others relate to the product, the middlemen and the company itself. Distribution intensity refers to a number of middlemen that a producer uses at the wholesale and retail levels in a particular territory. It ranges from intensive to selective to exclusive.

The channel management involves: selecting channel members, training channel members, motivating channel members, evaluating channel members and modifying channel arrangements.

Firms that distribute goods and services sometimes clash. There are two types of conflict; Horizontal (between firms at the same level of distribution) and Vertical (between firms at different levels of the same channel). Scrambled merchandising is a prime cause of horizontal conflict. Vertical conflict typically pits producer against wholesaler or retailer. Manufacturers' attempts to bypass middlemen are a prime cause of vertical conflict.

Channel members frequently strive for some control over one another. Depending on the circumstances either producers or middlemen can achieve the dominant position in a channel. The firms' comprising a particular channel are served best if they all view them as a partnership requiring coordination of distribution activities.

13.10 KEY WORDS

Channel of Distribution: A network of institutions that perform all the activities necessary for moving a product and its title from the manufacturer to the ultimate consumers or users.

Direct Distribution: The method of distribution under which manufacturers directly sell the products to consumers without engaging any intermediary.

Exclusive Distribution: Distribution of products through some limited outlets which are granted exclusive rights to distribute the firm's products in their respective territories.

Indirect Distribution: The method of distribution under which the products are moved from producers to users with the help of one or more intermediaries.

Intensity of Distribution: Distribution of products through a very large number of intermediaries at each level of marketing channel.

Multiple Channels of Distribution: Simultaneous use of different channels for the same product.

Selective Distribution: Distribution of products through a limited number of intermediaries at each level of the distribution channel.

13.11 TERMINAL QUESTIONS

1. What is distribution channel? Why is distribution channel important for flow of goods from producer to consumer?
2. Discuss various functions performed by distribution channels.
3. Draw a diagramme of consumer marketing channel and discuss the flow of goods by this channel giving suitable examples.
4. Draw a diagramme of industrial marketing channels and discuss the flow of goods by this channel giving suitable examples.
5. A new soft drink manufacturing company which has successfully launched its cola and lemon drinks in Mumbai is planning to introduce these products to the other three metropolitan cities in the country. What kind of distribution channel would you recommend to the company? What factors would you take into consideration while selecting the appropriate channel for the company?
6. Explain various steps involved in the channel design decisions. Give suitable examples.
7. Describe the process involved in the management of channel. How do they improve the efficiency of the channel members.
8. What is channel conflict? Identify the causes of channel conflict and suggest remedies for them.