CHAPTER 10

MARKETING CHANNELS

PREVIEWING THE CONCEPTS: CHAPTER OBJECTIVES

1. Explain why companies use marketing channels and discuss the functions these channels perform.
2. Discuss how channel members interact and how they organize to perform the work of the channel.
3. Identify the major channel alternatives open to a company.
4. Explain how companies select, motivate, and evaluate channel members.
5. Discuss the nature and importance of marketing logistics and integrated supply chain management.

CHAPTER OVERVIEW

This chapter deals with distribution.

An individual firm's success depends not only on how well *it* performs but also on how well its *entire marketing channel* competes with competitors' channels.

To be good at customer relationship management, a company must also be good at partner relationship management.

The first part of this chapter explores the nature of marketing channels and the marketer's channel design and management decisions.

We then examine physical distribution—or logistics—an area that is growing dramatically in importance and sophistication.

INTRODUCTION

Most firms cannot bring value to customers by themselves. Instead, they must work closely with other firms in a larger value-delivery network.

SUPPLY CHAINS AND THE VALUE DELIVERY NETWORK

The ***supply chain*** consists of "upstream" and "downstream" partners.

Upstream from the company is the set of firms that supply the raw materials, components, parts, information, finances, and expertise needed to create a product or service.

Marketers have traditionally focused on the "downstream" side of the supply chain—on the ***marketing channels*** (**or** ***distribution channels***) that look forward toward the customer.

A better term would be ***demand chain*** because it suggests a ***sense-and-respond*** view of the market.

Under this view, planning starts with the needs of target customers, to which the company responds by organizing a chain of resources and activities with the goal of creating customer value.

As defined in Chapter 2, a **value delivery network** is made up of the company, suppliers, distributors, and ultimately customers who "partner" with each other to improve the performance of the entire system.

THE NATURE AND IMPORTANCE OF MARKETING CHANNELS

Producers try to forge a **marketing channel** (or **distribution channel**)—a set of interdependent organizations that help make a product or service available for use or consumption by the consumer or business user.

How Channel Members Add Value

The role of marketing intermediaries is to transform the assortments of products made by producers into the assortments wanted by consumers.

Members of the marketing channel perform many key functions. Some help to complete transactions:

- *Information:* Gathering and distributing marketing research and intelligence information about actors and forces in the marketing environment needed for planning and aiding exchange.
- *Promotion*: Developing and spreading persuasive communications about an offer.
- *Contact*: Finding and communicating with prospective buyers.
- *Matching*: Shaping and fitting the offer to the buyer's needs, including activities such as manufacturing, grading, assembling, and packaging.
- *Negotiation*: Reaching an agreement on price and other terms of the offer so that ownership or possession can be transferred.

Others help to fulfill the completed transactions:

- *Physical distribution*: Transporting and storing goods.
- *Financing*: Acquiring and using funds to cover the costs of the channel work.
- *Risk taking*: Assuming the risks of carrying out the channel work.

Number of Channel Levels

A **channel level** is each layer of marketing intermediaries that performs some work in bringing the product and its ownership closer to the final buyer.

A **direct marketing channel** has no intermediary levels; the company sells directly to consumers.

An **indirect marketing channel** contains one or more intermediaries.

From the producer's point of view, a greater number of levels means less control and greater channel complexity.

CHANNEL BEHAVIOR AND ORGANIZATION

Channel Behavior

A marketing channel consists of firms that have partnered for their common good. Each channel member depends on the others.

Each channel member plays a specialized role in the channel. The channel will be most effective when each member assumes the tasks it can do best.

Disagreements over goals, roles, and rewards generate **channel conflict**.

Horizontal conflict occurs among firms at the same level of the channel.

Vertical conflict occurs between different levels of the same channel.

Vertical Marketing Systems

A **conventional distribution channel** consists of one or more independent producers, wholesalers, and retailers. Each is a separate business seeking to maximize its own profits, perhaps even at the expense of the system as a whole.

A **vertical marketing system (VMS)** consists of producers, wholesalers, and retailers acting as a unified system. One channel member owns the others, has contracts with them, or wields so much power that they must all cooperate.

A ***Corporate VMS*** integrates successive stages of production and distribution under single ownership.

A ***Contractual VMS*** consists of independent firms at different levels of production and distribution, who join together through contracts to obtain more economies or sales impact than each could achieve alone.

The **franchise organization** is the most common type of contractual relationship—a channel member called a ***franchisor*** links several stages in the production-distribution process.

There are three types of franchises.

1. The *manufacturer-sponsored retailer franchise system*—for example, Ford and its network of independent franchised dealers.
2. The *manufacturer-sponsored wholesaler franchise system*—Coca-Cola licenses bottlers (wholesalers) in various markets who buy Coca-Cola syrup concentrate and then bottle and sell the finished product to retailers in local markets.
3. The *service-firm-sponsored retailer franchise system*—examples are found in the

auto-rental business (Avis), the fast-food service business (Burger King), and the motel business (Holiday Inn).

In an ***Administered VMS,*** leadership is assumed not through common ownership or contractual ties but through the size and power of one or a few dominant channel members.

Horizontal Marketing Systems: Two or more companies at one level join together to follow a new marketing opportunity.

Multichannel Distribution Systems: Occurs when a single firm sets up two or more marketing channels to reach one or more customer segments.

Changing Channel Organization

Disintermediation occurs when product or service producers cut out intermediaries and go directly to final buyers, or when radically new types of channel intermediaries displace traditional ones.

CHANNEL DESIGN DECISIONS

Marketing channel design calls for analyzing consumer needs, setting channel objectives, identifying major channel alternatives, and evaluating them.

Analyzing Consumer Needs

As noted previously, marketing channels are part of the overall *customer-value delivery network*.

The company must balance consumer needs not only against the feasibility and costs of meeting these needs but also against customer price preferences.

Setting Channel Objectives

Companies should state their marketing channel objectives in terms of targeted levels of customer service.

The company should decide which segments to serve and the best channels to use in each case.

The company's channel objectives are influenced by the nature of the company, its products, its marketing intermediaries, its competitors, and the environment. Environmental factors such as economic conditions and legal constraints may affect channel objectives and design.

Identifying Major Alternatives

Types of Intermediaries

A firm should identify the *types*, *number*, and *responsibilities* of channel members available to carry out its channel work.

Number of Marketing Intermediaries

Companies must also determine the number of channel members to use at each level.

Three strategies are available:

1. **Intensive distribution:** Ideal for producers of convenience products and common raw materials. It is a strategy in which they stock their products in as many outlets as possible.
2. **Exclusive distribution:** Purposely limit the number of intermediaries handling their products. The producer gives only a limited number of dealers the exclusive right to distribute its products in their territories.
3. **Selective distribution:** This is the use of more than one, but fewer than all, of the intermediaries who are willing to carry a company's products.

Responsibilities of Channel Members

The producer and intermediaries need to agree on the terms and responsibilities of each channel member.

They should agree on price policies, conditions of sale, territorial rights, and specific services to be performed by each party.

Evaluating the Major Alternatives

Using ***economic criteria***, a company compares the likely sales, costs, and profitability of different channel alternatives.

Using ***control issues*** means giving them some control over the marketing of the product, and some intermediaries take more control than others.

Using ***adaptive criteria*** means the company wants to keep the channel flexible so that it can adapt to environmental changes.

Designing International Distribution Channels

In some markets, the distribution system is complex and hard to penetrate, consisting of many layers and large numbers of intermediaries.

At the other extreme, distribution systems in developing countries may be scattered, inefficient, or altogether lacking.

Sometimes local customs can greatly restrict how a company distributes products in global markets.

CHANNEL MANAGEMENT DECISIONS

Marketing channel management calls for selecting, managing, and motivating individual channel members and evaluating their performance over time.

Selecting Channel Members

When selecting intermediaries, the company should determine what characteristics distinguish the better ones.

Managing and Motivating Channel Members

The company must sell not only *through* the intermediaries but *to* and *with* them.

Most companies practice strong ***partner relationship management (PRM)*** to forge long-term partnerships with channel members.

Evaluating Channel Members

The company should recognize and reward intermediaries who are performing well and adding good value for consumers.

Those who are performing poorly should be assisted or replaced.

Companies need to be sensitive to their channel partners.

PUBLIC POLICY AND DISTRIBUTION DECISIONS

Exclusive distribution occurs when the seller allows only certain outlets to carry its products.

Exclusive dealing occurs when the seller requires that these dealers not handle competitors' products.

Exclusive arrangements exclude other producers from selling to these dealers. This brings exclusive dealing contracts under the scope of the Clayton Act of 1914.

Exclusive territorial agreements occur when the producer agrees not to sell to other dealers in a given area, or the buyer may agree to sell only in its own territory.

Full-line pricing occurs when producers of a strong brand sell it to dealers only if the dealers will take some or all of the rest of the line. This is also known as a ***tying agreement.***

In general, sellers can drop dealers "for cause."

MARKETING LOGISTICS AND SUPPLY CHAIN MANAGEMENT

Nature and Importance of Marketing Logistics

Marketing logistics—also called **physical distribution**—involves planning, implementing, and controlling the physical flow of goods, services, and related information from points of origin to points of consumption to meet customer requirements at a profit.

Marketing logistics involves ***outbound distribution*** (moving products from the factory to resellers and ultimately to customers), ***inbound distribution*** (moving products and materials from suppliers to the factory) and ***reverse distribution*** (moving broken, unwanted, or excess products returned by consumers or resellers).

It involves the entirety of **supply chain management**—managing upstream and downstream value-added flows of materials, final goods, and related information among suppliers, the company, resellers, and final consumers.

Companies today are placing greater emphasis on logistics for several reasons.

1. Companies can gain a powerful competitive advantage by using improved logistics to give customers better service or lower prices.
2. Improved logistics can yield tremendous cost savings to both the company and its customers.
3. The explosion in product variety has created a need for improved logistics management.
4. Improvements in information technology have created opportunities for major gains in

distribution efficiency.

5. Logistics affects the environment and a firm's environmental sustainability efforts (the development of a *green supply chain*).

Sustainable Supply Chain

Designing sustainable supply chains is simply the *right* thing to do. It's one more way that companies can contribute to saving our world for future generations.

Not only are sustainable channels good for the world, they're also good for a company's bottom line.

Companies green up their supply chains through greater efficiency, and greater efficiency means lower costs and higher profits.

Goals of the Logistics System

The goal of marketing logistics should be to provide a ***targeted*** level of customer service at the least cost.

Major Logistics Functions

Warehousing

A company must decide ***how many*** and ***what types*** of warehouses it needs and ***where*** they will be located.

Storage warehouses store goods for moderate to long periods.

Distribution centers are designed to move goods rather than just store them.

Inventory Management

Just-in-time logistics systems: Producers and retailers carry only small inventories of parts or merchandise, often only enough for a few days of operations.

Transportation

Trucks have increased their share of transportation steadily and now account for 40 percent of total cargo ton-miles.

70 percent of all the freight tonnage moved in the United States goes on trucks.

Trucks are highly flexible in their routing and time schedules, and they can usually offer faster service than railroads.

They are efficient for short hauls of high-value merchandise.

Railroads account for 26 percent of total cargo ton-miles moved.

They are one of the most cost-effective modes for shipping large amounts of bulk products—coal, sand, minerals, and farm and forest products—over long distances.

Water carriers account for 7 percent of cargo ton-miles and transport large amounts of goods by ships and barges on U.S. coastal and inland waterways.

Although the cost of water transportation is very low for shipping bulky, low-value, nonperishable products, it is the slowest mode and may be affected by the weather.

Pipelines account for 17 percent of cargo ton-miles and are a specialized means of shipping petroleum, natural gas, and chemicals from sources to markets.

Air carriers transport less than 1 percent of the nation's goods. Airfreight rates are much higher than rail or truck rates.

The ***Internet*** carries digital products from producer to customer via satellite, cable, or phone wire.

Multimodal transportation: Combining two or more modes of transportation.

- ***Piggyback:*** Rail and trucks;
- ***Fishyback:*** Water and trucks;
- ***Trainship****:* Water and rail;
- ***Airtruck:*** Air and trucks.

Logistics Information Management

Electronic data interchange (EDI) is the computerized exchange of data between organizations.

Vendor-managed inventory **(VMI)** systems or ***continuous inventory replenishment*** systems, is the customer sharing real-time data on sales and current inventory levels with the supplier. The supplier then takes full responsibility for managing inventories and deliveries.

Integrated Logistics Management

Integrated logistics management is a concept which recognizes that providing better customer service and trimming distribution costs require ***teamwork***, both inside the company and among all the marketing channel organizations.

Cross-Functional Teamwork inside the Company

The goal of integrated supply chain management is to harmonize all of the company's logistics decisions.

Close working relationships among departments can be achieved in several ways.

- Permanent logistics committees, made up of managers responsible for different physical distribution activities
- Supply chain manager positions that link the logistics activities of functional areas
- System-wide supply chain management software

Building Logistics Partnerships

Cross-functional, cross-company teams**:** For example, Nestlé's Purina pet food unit has a team of dozens of people working in Bentonville, AR, the home of Wal-Mart. They work jointly with their counterparts at Wal-Mart to find ways to squeeze costs out of their distribution system.

Shared projects**:** For example, Home Depot allows key suppliers to use its stores as a testing ground for new merchandising programs.

Third-Party Logistics

Third-party logistics (3PL) providers help clients tighten up overstuffed supply chains, slash inventories, and get products to customers more quickly and reliably. (Also called ***outsourced logistics*** or ***contract logistics.***)

Companies use third-party logistics providers for several reasons.

1. These providers can often do it more efficiently and at lower cost.
2. Outsourcing logistics frees a company to focus more intensely on its core business.
3. Integrated logistics companies understand increasingly complex logistics environments.

Self-Check Questions

10-1. Compare and contrast upstream and downstream partners in a company's supply chain. Explain why value delivery network might be a better term to use than supply chain.

10-2. Compare direct marketing channels and indirect marketing channels. Name the various types of resellers in marketing channels.

10-3. Name and describe the three strategies available when determining the number of marketing intermediaries.

10-4. List and briefly describe the major logistics functions. Provide an example of a decision a logistics manager would make for each major function.