Chart Your Channels

Channel Management

Isabella's government class team has been assigned a group presentation. She and the three other group members have divided the responsibilities according to their strengths—Isabella will do the reading and create an outline, Ben will take the outline and create a software presentation, Alicia will proof the presentation for spelling and grammar, and Erik will make the presentation and lead the class discussion. Isabella, Ben, Alicia, and Erik have created something similar to the channels businesses use to get their products to customers. In this case, their "product" is their knowledge on a certain topic, and their "customers" are their teacher and the rest of their class. They've worked together to deliver that knowledge in the most efficient, effective way possible.

Channels work well when they're properly managed and when channel members strive together to achieve a common goal. Each member adds value to the product as it makes its way to the final consumer.

Objectives

A Explain key functions of channels of distribution.

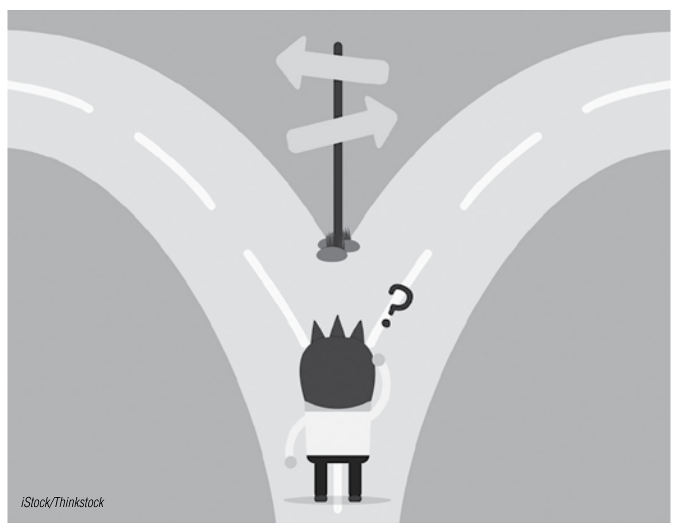
B Discuss decisions involved in channel management.

A

Getting the Job Done: It's a Group Effort

Channels of distribution

Businesses have many different options for moving their **products** to the consumers and businesses who want to buy them. These routes are known as **channels of distribution**. We all benefit from channels of distribution. As consumers, we benefit when we are able to purchase certain products, in certain quantities, when and where we want to. For example, you may live in Cincinnati but, at the grocery store down the street, you can buy a single bar of chocolate produced in Switzerland. Have you ever thought about the path that chocolate bar took to get into your hand?



▲ Channel management is responsible for determining which channels of distribution to use to get products to customers.

Businesses also benefit from channels of distribution, both when they buy products and when they sell them. As buyers, they can get the products they need when they need them. A school, for instance, can order 100 new desks. As sellers, businesses can use channels of distribution to get their products to final consumers more effectively and efficiently.

As with most aspects of business, channels of distribution have changed significantly as technology continues to evolve. Check out this video to learn more: http://www.inc.com/steve-blank/what-you-need-to-know-about-distribution-channels.html.

Channel tasks

How do channels of distribution allow businesses to get products to final consumers as effectively and efficiently as possible? It's important to know that, as products move through these channels, many activities must occur. These tasks must be completed no matter how many **intermediaries** are involved. Let's take a look at several channel tasks:

Providing marketing information. Every producer is trying to reach and sell to a specific **target market** for each of its products. Companies rely on **market research** to determine their target markets' needs and wants. Intermediaries are often closer to final consumers than producers themselves. Let's say you have a small business producing handmade greeting cards that you sell through a few small local retail stores. One of the store owners informs you that several customers have commented on your birthday cards and have asked if you create anniversary cards as well. This is **marketing information** that is valuable to you, information you wouldn't have learned if not for your fellow **channel member**. Many companies benefit in this same manner, only on a much larger scale.

Quick Definitions:

- **Ultimate consumers**—people who personally use products to satisfy their own wants
- **Industrial users**—businesses that buy materials, services, or goods that will be used to make other goods or used in the operation of the company
- **Intermediaries**—channel members operating between producer and consumer to help in the movement of products; also called middlemen
- **Producers**—people who make or provide goods and services
- **Wholesalers**—channel members who help to move goods between producers and retailers by buying goods from producers and selling them to retailers
- **Retailers**—businesses that buy consumer goods or services and sell them to ultimate consumers

Promoting products. Promoting a product, especially a new one, can be expensive. When a producer sells its products through intermediaries, the costs and responsibilities associated with product **promotion** can be shared. Retailers often assume a large portion of promotion responsibilities. Think about your local supermarkets and discount stores—most likely, they produce weekly flyers featuring a variety of products available or on sale. These retailers may pay the full costs to produce the flyers, or they may share expenses with some of the products' manufacturers. Shared promotion activities within the channel can lower channel members' individual costs while producing the same results.

Negotiating with customers. Producers often don't have the time or the ability to negotiate with final consumers on issues such as price, delivery, installation, etc. In a channel of distribution, a producer can sell 100,000 big-screen television sets to a wholesaler at one price, the wholesaler can sell 1,000 of them to a retailer at another price, and the retailer can sell them individually to consumers at yet another price, a price that retailers determine consumers are willing to pay. And, if many consumers have difficulty getting their new big-screen TVs home, the retailer may offer to deliver and set up each big-screen it sells. When the channel works smoothly, all the channel members are profitable, and the final consumer receives the product in an efficient, effective manner.

▲ To increase sales, retailers sometimes negotiate price, delivery, and installation terms with final consumers.

Reducing discrepancies. There are several barriers that keep producers and final consumers from dealing with each other effectively. These "discrepancies" of quantity and assortment are issues that middlemen can solve. Consider a producer of diapers. It certainly produces more diapers than any consumer needs at one time. By selling large quantities of diapers to wholesalers and retailers, the producer can continue producing on a large scale without having to worry about storing the diapers or breaking them down into smaller quantities for individual sale. Wholesalers and retailers can break down these large quantities into reasonable amounts for final consumers, and they can also offer an appropriate assortment of related products in one place. Since there is no single producer that provides every single baby product a consumer might want or need, a retailer such as a baby superstore collects a variety of baby products from a number of different producers and makes them available for one-stop shopping.

▲ Babies R Us and other superstores typically purchase products from several different producers, making them intermediaries in multiple companies' channels of distribution.

Financing and risk-taking. Moving products through a channel costs money. It takes money to manufacture products, to **transport** and store them, to promote them, to gather information about target market needs, to extend credit to consumers, etc. When channel members work together to finance these activities and to assume the inherent financial **risks**, channels will be more effective.

Planning expert Tim Berry provides more insight into the important tasks of channel members in his article "Channel Marketing Moves Goods from Producers to Consumers." You can read the article here: http://www.mplans.com/articles/channel-marketing-moves-goods-from-producers-to-consumers/.

True value

Every channel member should add **value** to the product as it moves through the channel. Adding value to the product benefits all channel members. If a member does not add value, channel managers need to reevaluate whether or not that member belongs in the channel. There are several ways that channel members add value.

As we've learned, it is often impractical for a producer to perform all of the activities needed to get its product into the hands of final consumers. Any channel member that can perform one or more of these tasks expertly adds value. Retailers, for example, are **point-of-sale** advertising specialists and may create exciting visual displays in their stores to promote a manufacturer's product. By performing this task, which should lead to higher sales volume, retailers can add value to the product and benefit every member in the channel.

Learn more about how channel members can add value before a sale, during a sale, and after a sale by reading Stanley Glancy's article "True Value Added Distribution" at http://www.streetdirectory.com/travel_guide/125188/computers/true_value_added_distribution.html.

The Gray Zone

Middlemen often hit producers with chargebacks (financial penalties) when products don't arrive in good shape. But, what if the merchandise is damaged as a result of the shipping company's or postal service's negligence, not because of the producer? Middlemen may have a legal right to issue a chargeback, but is it ethical? What do you think?

A

Summary

Channels of distribution are the paths, or routes, that goods or services take from the producer to the ultimate consumer or industrial user. These channels benefit both consumers and businesses. Channel members perform many important tasks, such as providing marketing information, promoting products, negotiating with customers, reducing discrepancies, and financing and risk-taking. Every channel member should add value to the product by performing specialized activities to lower costs and move products efficiently through the channel.

TOTAL RECALL

1. How do consumers benefit from channels of distribution?
2. How do businesses benefit from channels of distribution?
3. What activities occur in a channel of distribution?
4. How do channel members add value to a product?

B

Design Time: Making Channel-Management Decisions

Prime performance

Sometimes, waterways are referred to as channels. Picture water flowing through a channel. What happens if something clogs the channel, such as trash or debris, or if something blocks the channel completely, such as a dam? The water doesn't move through efficiently. The same principle applies to channels of distribution. A few conditions must exist for channels to be effective.

First, the channel must be properly managed. That is, marketers designing channels and overseeing channel strategies must first recognize the importance of their task and then make informed decisions regarding distribution patterns as well as the selection of channel members and assignment of their responsibilities.

Second, channels are effective only if channel members share a common goal or goals. Channel members should share a commitment to the quality of the product and to satisfying the target market's needs and wants. After all, no business in the channel will be successful if the products don't sell.

Third, channel members must share tasks appropriately if the channel is to be effective. Channel tasks should be assigned to the members who can perform them best. For example, a wholesaler probably isn't a specialist in advertising promotions if it doesn't deal directly with final consumers. A retailer would be better suited for this activity because it has contact with ultimate consumers every day. When channel members divide tasks appropriately, it makes it easier for them to cooperate and work toward their common goal.

▲ Channels of distribution are only effective if every channel member shares a common goal.

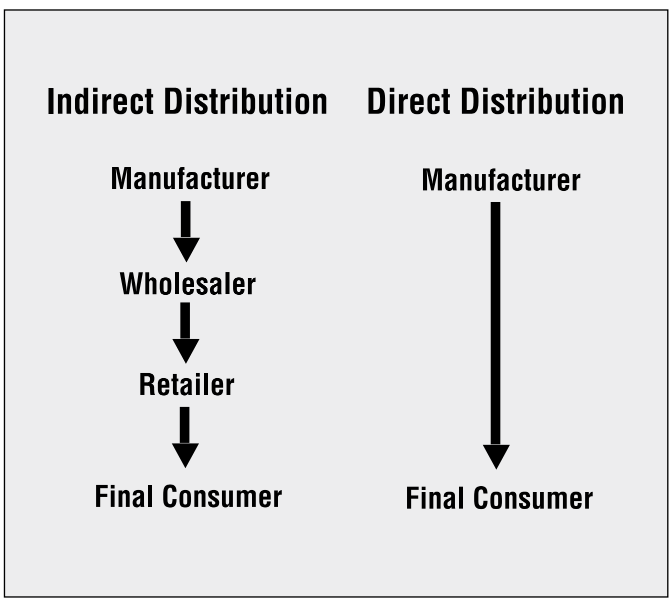
Before marketers can make decisions about channel management, they must review the company's overall marketing objectives and the role it has assigned to distribution in the marketing mix. Channel design and strategy should support these objectives.

Just for Fun!

Check out this travel article entitled “Great Waterways of the World”: http://www.lonelyplanet.com/travel-tips-and-articles/76524. What would happen if these channels didn’t move efficiently? Consider this question in light of the fact that waterways were, at one time, the world’s main method of getting goods from producers to consumers!

Channel-management decisions

Setting channel objectives. Marketers can’t begin designing channels and selecting channel members before they’ve determined what they’re trying to achieve. In general, marketers want channels to meet the needs and wants of their target markets efficiently and to give their product a competitive edge in the marketplace. Marketers often set more specific goals as well. For instance, a manufacturer may decide it wants to use as many channel members as possible so it can spread out its distribution risks and expenses. Or, a manufacturer may decide to forgo **indirect distribution** (the use of **middlemen**) and use **direct distribution**, eliminating middlemen in the channel and dealing with final consumers directly. As we’ve learned, though, this is often impractical. For more on the advantages and disadvantages of direct distribution, read Forest Time’s article “What is a Direct Channel of Distribution?” You can find the article here: http://smallbusiness.chron.com/direct-channel-distribution-42213.html.



Determining distribution patterns. Marketers want to achieve something called **ideal market exposure**—that is, they want to make their product available to each and every customer who might buy it, but they don’t want to over-distribute the product and waste money. To achieve ideal market exposure, marketers must determine **distribution intensity**. Distribution patterns are determined by considering consumer needs as well as the nature of the product itself. These patterns may be:

- **Intensive. Intensive distribution** means selling a product through every available wholesaler and retailer in a geographic area where consumers might look for it. Marketers use this method when they are attempting to reach the greatest number of consumers possible. Convenience products are often distributed this way. Consider all the different places you can pick up a pack of gum. As a consumer, you want to be able to buy this product easily—you don’t want to have to shop around for it. Therefore, marketers will try to make it available wherever you might feel like buying it. For more on the benefits of intensive distribution, see http://www.distributionstrategy.org/Intensive-Distribution-Strategy.html.

- **Selective. Selective distribution** means selling a product through a limited number of wholesalers and retailers in a geographic area. Marketers use this method when they want to deal with the middlemen they feel will do the best job of promoting and selling their products. Companies may actually be able to make higher profits using selective distribution, by creating greater sales volume through a smaller number of successful outlets. Consumer shopping goods are often distributed this way. For instance, many high-end clothing manufacturers, such as Michael Kors or The North Face, distribute their products through selected retailers only.

- **Exclusive. Exclusive distribution** means selling a product through just one middleman in a geographic area. Marketers use this method when they need to maintain tight control over a product. This is why exclusive distribution is often used for specialty products that are technical in nature or require specialized services such as installation or repair. Examples of these products are airplanes and large machinery.

Selecting channel members. Before selecting specific channel members, marketers must determine the types of members that belong in the channel (wholesalers, retailers, etc.) and also determine **channel length** (total number of channel members). Channel member types are usually based on the nature of the product. A consumer product, for instance, doesn’t go through an industrial distributor; conversely, an industrial product doesn’t go through a retailer. Channels may be long or short, depending on what makes the most economic sense.

A long channel may spread financial risk and allow a product to receive more specialized attention. On the other hand, a short channel may allow a product to reach consumers more quickly.

There are a number of factors marketers must consider when choosing specific channel members. Each middleman should:

- Create product value that the producer or other middlemen cannot or are not willing to provide (shipping, promoting, etc.)
- Channel the product to its desired target market(s)
- Have a pricing and promotion strategy compatible with the product's needs
- Offer customer service compatible with the product's needs
- Be willing and able to work cooperatively with other members within the product's channel

Determining channel responsibilities. As you know, certain activities must take place within a channel, no matter which channel member performs them. Products must be shipped, promoted, and sold to final consumers before any profits can be made. Determining channel responsibilities is an important part of **channel management**. Channels are effective only when members work together appropriately and perform the tasks they are best suited for. For example, we know that middlemen reduce discrepancies by breaking down large quantities and storing products until consumers are ready to buy them. A wholesaler works with a retailer to ensure that the retailer always has enough of a product in stock. The wholesaler and retailer must work together to determine which firm is responsible for keeping track of product inventory, and, if they are both partially responsible, which part of the task belongs to which firm.

▲ Wholesalers and retailers must communicate with each other to ensure that the retailer always has sufficient inventory.

Managing, motivating, and monitoring channel members. It isn't always easy to keep a channel flowing smoothly. That's why channel management is so important. Marketers should constantly evaluate the channel to see what's working, what isn't, and what can be improved. Should members be added or deleted? Should certain responsibilities be reassigned? These questions can only be answered if marketers keep a close eye on the channel and keep their goals in mind.

Since there may be several members involved in one channel, who makes channel-management decisions? This may be a difficult question to answer—one that can create conflict within channels. Traditionally, producers controlled channels and made all the decisions. However, in modern channels, power tends to be distributed more evenly among members or even tilted toward retailers (consider powerful retailers such as Walmart). Company size and finances have a lot to do with it, too. Small producers may not have much choice when marketing a new product. They may have to work with any middlemen who are willing to take a risk with them.

Channel members can be motivated in a number of ways. Motivation can be either positive or negative. On the negative side, marketers may impose **sanctions** on middlemen who do not perform well. For instance, if a middleman does not meet the sales quota in its contract, a manufacturer may reduce the wholesale discount the middleman receives. Middlemen can also hit producers with **chargebacks**, financial penalties assessed for a variety of problems, such as late shipments or damaged merchandise. On the positive side, marketers can offer **incentives** (usually financial) for reaching certain performance goals—a sales contest, for example. Marketers can also motivate channel members by reinforcing the product on a regular basis—providing product training, sending out product update letters, participating in cooperative advertising, etc. In general, positive measures are more effective for motivation than negative measures.

For more on the importance of motivating channel members, see Julie Davoren's article "The Importance of Motivation to Distribution Channel Members." You can read it here: http://smallbusiness.chron.com/importance-motivation-distribution-channel-members-14227.html.

A major component of channel management is handling conflict. Conflict can arise all too often when independent businesses try to work together to form one channel. There are two basic types of channel conflict:

- **Horizontal conflict**—This type of conflict occurs between channel members at the same level. In essence, horizontal conflict is good, old-fashioned business competition. Two middlemen on the same level (two retailers selling pet supplies, for example) compete to sell the same manufacturer's product to the same target market.

- **Vertical conflict**—This type of conflict occurs between channel members at different levels within the same channel. This is the type of conflict that channel managers must pay close attention to. Usually, vertical conflict occurs between producers and wholesalers or producers and retailers. Producers may not feel that middlemen are marketing and selling their products aggressively enough. Wholesalers and retailers may feel that producers' demands are unreasonable. Conflict can also arise when producers bypass traditional middlemen in favor of **e-commerce** options or opening their own factory-direct retail stores. **Multiple** or **dual distribution** can cause conflict as well. This occurs when producers use more than one channel to distribute a product, creating horizontal and vertical conflict at the same time. Managing vertical conflict can be a challenge, and there aren't always easy solutions for marketers. They must, however, learn to recognize and address conflict when and where it occurs, so the channel can continue to flow smoothly.

Amy Lanigan explains how some manufacturers deal with channel conflict created by e-commerce in her article "Six Models for Tackling Channel Conflict" at http://www.fluid.com/strategy/six-models-for-tackling-channel-conflict.

Summary

Channels of distribution are effective only when they are properly managed, when members share common goals, and when responsibilities are assigned appropriately. Channel-management decisions include setting channel objectives, determining distribution patterns, selecting channel members, determining channel responsibilities, and managing, motivating, and monitoring channel members.

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1. When are channels most effective?
2. What decisions are involved in channel management?

Make It Pay!

Choose one good or service you've consumed today. Consider the channel activities that occurred before this product reached you. How do you think channel members added value to this product? What pattern of distribution do you think was used?

