

To open a shop is easy; to keep it open is an art.

CONFUCIUS (PHILOSOPHER)

Place

Chapter 20 Managing marketing channels

THE FINAL PART of this text addresses the fourth element of the marketing mix – place. It will help you to understand the decisions and actions that companies take in order to bring products and services to customers. It also considers how new information and communication technologies are transforming distribution and retailing functions.

How products and services are delivered to customers for final usage or consumption can make a difference to how customers perceive the quality and value of the overall offering. Speed of delivery, guaranteed supply and availability, convenience to shoppers and so forth can enhance buyer–seller relationships and increase customer satisfaction. Consequently, firms are increasingly paying greater attention to how they manage their distribution or marketing channels to deliver goods and services that customers want at the right time, right place and right price. In **Chapter 20**, our final chapter, we address channel organisations and the functions they perform and show how firms can build more cost-effective routes to serving and satisfying their target markets.

PART eight



H&M

H&M

Prepare yourself

Prepare yourself

Keep your shop and your shop
will keep you.

THOMAS FULLER

Managing marketing channels

CHAPTER

twenty

Chapter objectives

After reading this chapter, you should be able to:

- Explain why companies use marketing channels and discuss the functions these channels perform.
- Discuss how channel members interact and how they organise to perform the work of the channel.
- Identify the major channel alternatives open to a company and how companies select, motivate and evaluate channel members.
- Discuss the nature and importance of retailers, wholesalers and physical distribution.
- Explain integrated logistics, including how it may be achieved and its benefits to the company.

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Prelude case Dell Corporation



What if a manufacturing company didn't need to have any inventory? Imagine the reduction to cost structure that could be achieved by simply getting rid of the need to carry huge amounts of finished goods on its books – and eliminating the nail-biting stress of waiting until those goods are sold. For Michael Dell, founder and CEO of Austin, Texas-based Dell Corporation, very little imagination is required. He has built a company with annual revenues in excess of \$40bn entirely around a vision whereby manufacturing of an individual item does not begin until it has been ordered by a customer. Every single Dell product has an end user's name on it before it even leaves the factory.

Every single Dell product has an end user's name on it before it even leaves the factory.

Visiting a Dell factory gives you an idea of just how effective Michael Dell has been in executing this supply chain management philosophy. At the company's Irish factory near Limerick, for example, there are 40 doors at one end of the factory that deliver the parts needed to build a variety of products – including desktop computers and servers – and 40 doors at the other end of the factory where the finished goods are dispatched to be delivered to customers. The company never holds more than four hours'

worth of parts inventory at any time – and Dell is not even considered to have acquired the parts until the moment they are offloaded from a truck and brought into the factory. The same process is used in Dell operations throughout the world, including the company's showcase factory at its US headquarters in Austin.

After the parts are unloaded, the process of building individual, custom-made systems begins. All the parts that are needed for the assembly of a given system are placed in a plastic box that passes along a conveyor belt and is then routed to an assembler. Each part is scanned – along with a label denoting the name, address and details of the buyer (including the specifications of the system that has been ordered) – so that individual parts are associated with individual systems sold to individual buyers. This means that if a problem with a given part is discovered at any point, the company knows exactly which systems contain that part and can notify the owners about the need for a fix. In addition, it means that if a buyer reports problems, Dell's technical support system can pull up the details of what was installed in the system at the factory, when it was assembled, and by whom.

Over the past year, Dell has started to build products other than desktop, server and notebook computer systems using this method of manufacturing – and recently changed its corporate name [from Dell Computer Corporation to Dell Corporation] to reflect this fact. It is all part of the 'Dell model' that Michael Dell says is just as applicable to manufacturing computer printers, handheld computers and MP3 players as it is to a personal computer. 'If we look across the whole \$800bn IT market, we see that there is a kind of standardisation and commoditisation

occurring across many different product areas, so we have tried to understand what the best opportunities are for us to deliver value', he said in a recent interview. Mr Dell also said that the direct manufacturing model gave his company an unparalleled insight into the kinds of product areas that his company should move into – as well as those from which it should retreat. 'One of the magic abilities of any great product company is to understand technologies and customer requirements and come up with the perfect combination to solve a problem', said Mr Dell, although he admits that customers sometimes do not realise that they have a problem that technology can solve. 'The customer is not likely to come and say they need a new metallic compound used in the construction of their notebook computer, but they may tell us they need a computer that is really light and rugged. Where some companies fall down is that they get enamoured with the idea of inventing things – and sometimes what they invent is not what people need.' He said that by using the Dell model, he knows very quickly when a product isn't going to sell. 'When we launch a new product, we know within 48 hours whether or not it's going to work', he says. 'We had a Web PC that didn't turn out so well. But if you have no experiments, then you have no success. Occasionally, you just miss.'

Mr Dell concluded that by having a sales, manufacturing and distribution model where the maximum possible number of variables are under its control, the company has been in a position to grow significantly during the recent economic downturn. 'We have a fortunate situation in our business', he said. 'To the extent that there are tensions in the economy, we tend to be a more attractive choice. We have done well in tough economies – and we have a very efficient system that works well in many different economic environments.'

Questions

1. Taking the case of computer products, identify the supply chain for the distribution of these products and explain the channel service needs of customers. To what extent are store- and non-store-based distribution channels alike or different in terms of the channel functions they perform?
2. What are the advantages and disadvantages of the 'Dell model' of sales, manufacturing and distribution?
3. How might Dell sustain its competitive advantage in an increasingly competitive and mature market place? What channel strategies should it consider to enhance its value delivery network? Justify.

SOURCE: This case is a reproduction of Geof Wheelwright, 'Bytes to order', *Financial Times*, *FT Understanding supply chain execution* (26 November 2003), p. 15.

Introduction

In this chapter, we will examine the last of the marketing mix tools – place. Firms rarely work alone in bringing value to customers. Instead, most are only a single link in a larger supply chain or distribution channel. As such, 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. For example, Mercedes can make the world's best cars but still not do well if its dealers perform poorly in sales and service against the dealers of Ford, Toyota, BMW or Honda. In order to bring value to customers, Mercedes must choose its channel partners carefully and practise sound partner relationship management.

In the first part of this chapter, we address the basics of marketing channel design and channel partner relationship management. Then we will look more deeply into the two major intermediary channel functions, retailing and wholesaling. We investigate the characteristics of different kinds of retailers and wholesalers, the marketing decisions they make and trends for the future. You'll see that the retailing and wholesaling landscapes are changing rapidly to match explosive changes in markets and technology.

Specifically, in this chapter, we examine the following questions concerning marketing channels:

- What is the nature of marketing channels?
- How do channel firms organise to do the work of the channel?
- What problems do companies face in designing and managing their channels?
- What role does physical distribution play in attracting and satisfying customers?
- How are marketing channels changing and what are their implications for marketers?

Most firms cannot bring value to customers by themselves. Instead, they must work closely with other firms in a larger value delivery network. Let us take a look at what is meant by a value delivery network.

Supply chains and the value delivery network

Producing a product or service and making it available to buyers requires building relationships not just with customers, but also with key suppliers and resellers in the company's *supply chain*. This supply chain consists of upstream and downstream partners, including suppliers, intermediaries and even intermediaries' customers.

Upstream from the manufacturer or service provider is the set of firms that supply the raw materials, components, parts, information, finances and expertise needed to create a product or service. Marketers, however, have traditionally focused on the 'downstream' side of the supply chain – on the *marketing channels* or *distribution channels* that look forward towards the customer. Marketing channel partners such as wholesalers and retailers form a vital connection between the firm and its target consumers.

Both upstream and downstream partners may also be part of other firms' supply chains. But it is the unique design of each company's supply chain that enables it to deliver superior value to customers. An individual firm's success depends not only on how well *it* performs but also on how well its entire supply chain and marketing channel competes with competitors' channels.

The term *supply chain* may be too limited – it takes a *make-and-sell* view of the business. It suggests that raw materials, productive inputs and factory capacity should serve as the starting point for market planning. 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 organising resources with the goal of building profitable customer relationships.

Even a demand chain view of a business may be too limited, because it takes a step-by-step linear view of purchase–production–consumption activities. With the advent of the Internet, however, companies are forming more numerous and complex relationships with other firms. For example, companies such as Toyota, Mercedes and Ford manage numerous supply chains. They also sponsor or transact on many B2B websites and online purchasing exchanges as needs arise. Like these companies, many large companies today are engaged in building and managing a continuously evolving *value delivery network*.

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. For example, Palm, the leading manufacturer of handheld devices, manages a whole community of suppliers and assemblers of semiconductor components, plastic cases, LCD displays and accessories, of offline and online resellers, and of 45,000 complementors who have created over 5,000 applications for the Palm operating systems. All of these diverse partners must work effectively together to bring superior value to Palm’s customers.

This chapter focuses on marketing channels – on the downstream side of the value delivery network. However, it is important to remember that this is only part of the full value network. To bring value to customers, companies need upstream supplier partners just as they need downstream channel partners. To provide banking services, for example, HSBC buys equipment and supplies such as automated teller machines (ATMs), printed deposit slips and computers. To make its services available to customers and obtain information about customer transactions, the bank maintains a distribution channel consisting of company-owned bank branches and websites as well as thousands of ATMs owned by other banks. Increasingly, marketers are participating in and influencing their company’s upstream activities as well as its downstream activities. More than marketing channel managers, they are becoming full network managers.

Value delivery network—

A network made up of the company, suppliers, distributors and customers who ‘partner’ with each other to improve the performance of the entire system.

The nature and importance of marketing channels

Few producers sell their goods directly to the final users. Instead, most use third parties or intermediaries to bring their products to market. They try to forge a **marketing channel** (or **distribution channel**) – a set of interdependent organisations involved in the process of making a product or service available for use or consumption by the consumer or business user.¹ The channel of distribution is therefore all those organisations through which a product must pass between its point of production and consumption.²

A company’s channel decisions directly affect every other marketing decision. The company’s pricing depends on whether it uses mass merchandisers or high-quality speciality stores. The firm’s sales force and advertising decisions depend on how much persuasion, training and motivation the dealers or resellers need. Whether a company develops or acquires certain new products may depend on how well those products fit the abilities of its channel members.

Companies often pay too little attention to their distribution channels, however, sometimes with damaging results. In contrast, many companies have used imaginative

Marketing channel

(distribution channel)—

A set of interdependent organisations involved in the process of making a product or service available for use or consumption by the consumer or industrial user.

distribution systems to *gain* a competitive advantage. For example, the creative and imposing distribution system created by FedEx made it a leader in the small-package delivery industry. Amazon.com pioneered the delivery of books via the Internet. And Dell Corporation revolutionised its industry by selling personal computers directly to consumers rather than through retail stores. As we saw in the prelude case, an effective supply chain management model lay at the very heart of Dell's success.

Distribution channel decisions often involve long-term commitments to other firms. For example, companies such as BMW, Nokia or McDonald's can easily change their advertising, pricing or promotion programmes. They can scrap old products and introduce new ones as market tastes demand. But when they set up distribution channels through contacts with franchises, independent dealers or large retailers, they cannot readily replace these channels with company-owned stores if conditions change. Therefore, management must design its channels carefully, with an eye on tomorrow's likely selling environment as well as today's.

How channel members add value

Why do producers give some of the selling job to intermediaries? After all, doing so means giving up some control over how and to whom the products are sold. The use of intermediaries results from their greater efficiency in making goods available to target markets. Through their contacts, experience, specialisation and scale of operation, intermediaries usually offer the firm more than it can achieve on its own.

Figure 20.1 shows how using intermediaries can provide economies. Part A shows three manufacturers, each using direct marketing to reach three customers. This system requires nine different contacts. Part B shows the three manufacturers working through one distributor, which contacts the three customers. This system requires only six contacts. In this way, intermediaries reduce the amount of work that must be done by both producers and consumers.

From the economic system's point of view, the role of marketing intermediaries is to convert the assortments of products made by producers into the assortments wanted by consumers. Producers make narrow assortments of products in large quantities, but consumers want broad assortments of products in small quantities. In the marketing channels, intermediaries buy the large quantities of many producers and break them down into the smaller quantities and broader assortments wanted by consumers. As such, intermediaries play an important role in matching supply and demand.

The concept of marketing channels is not limited to the distribution of tangible products. Producers of services and ideas also face the problem of making their output available to target populations. Hotels, banks, airlines and other service providers take great care to make

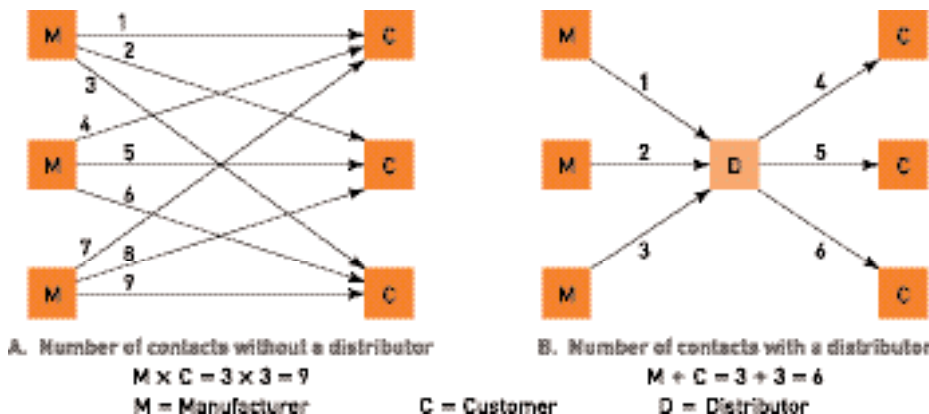


Figure 20.1 How a marketing intermediary reduces the number of channel transactions and raises economy of effort

their services conveniently available to target customers. Social service organisations and agencies develop ‘education delivery systems’ and ‘healthcare delivery systems’ for reaching sometimes widely dispersed populations. Hospitals must be located to serve various patient populations, and schools must be located close to the children who need to be taught. Communities must locate their fire stations to provide rapid response to fires and polling stations must be placed where people can vote conveniently.

In making products and services available to consumers, channel members add value by bridging the major time, place and possession gaps that separate goods and services from those who would use them. 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 facilitating 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 such activities 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 fulfil 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.

The question is not *whether* these functions need to be performed, but rather *who* is to perform them. To the extent that the manufacturer performs these functions, its costs go up and its prices have to be higher. At the same time, when some of these functions are shifted to intermediaries, the producer’s costs and prices may be lower, but the intermediaries must charge more to cover the costs of their work. In dividing the work of the channel, the various functions should be assigned to the channel members who can add the most value for the cost.

Number of channel levels

Companies can design their marketing channels to make products and services available to customers in different ways. Each layer of marketing intermediaries that performs some work in bringing the product and its ownership closer to the final buyer is a **channel level**. Because the producer and the final consumer both perform some work, they are part of every channel. The *number of intermediary levels* indicates the *length* of a channel. Figure 20.2A shows several consumer distribution channels of different lengths.

Channel 1, called a **direct-marketing channel**, has no intermediary levels. It consists of a manufacturer selling directly to consumers. For example, Avon and Tupperware sell their products door-to-door or through home and office sales parties. Wine clubs, such as Laithwaites and The Wine Society in the UK, sell their wines through mail order, telephone or at their websites. Marks & Spencer sells its products through its own stores, offline and online, as well as through mail order and telephone. And a university may deliver education on its campus or through distance (or off-campus) learning.

The remaining channels in Figure 20.2A are *indirect*-marketing channels containing one or more intermediaries. Figure 20.2B shows some common business distribution channels. The

Channel level—A layer of intermediaries that performs some work in bringing the product and its ownership closer to the final buyer.

Direct-marketing channel—A marketing channel that has no intermediary levels.

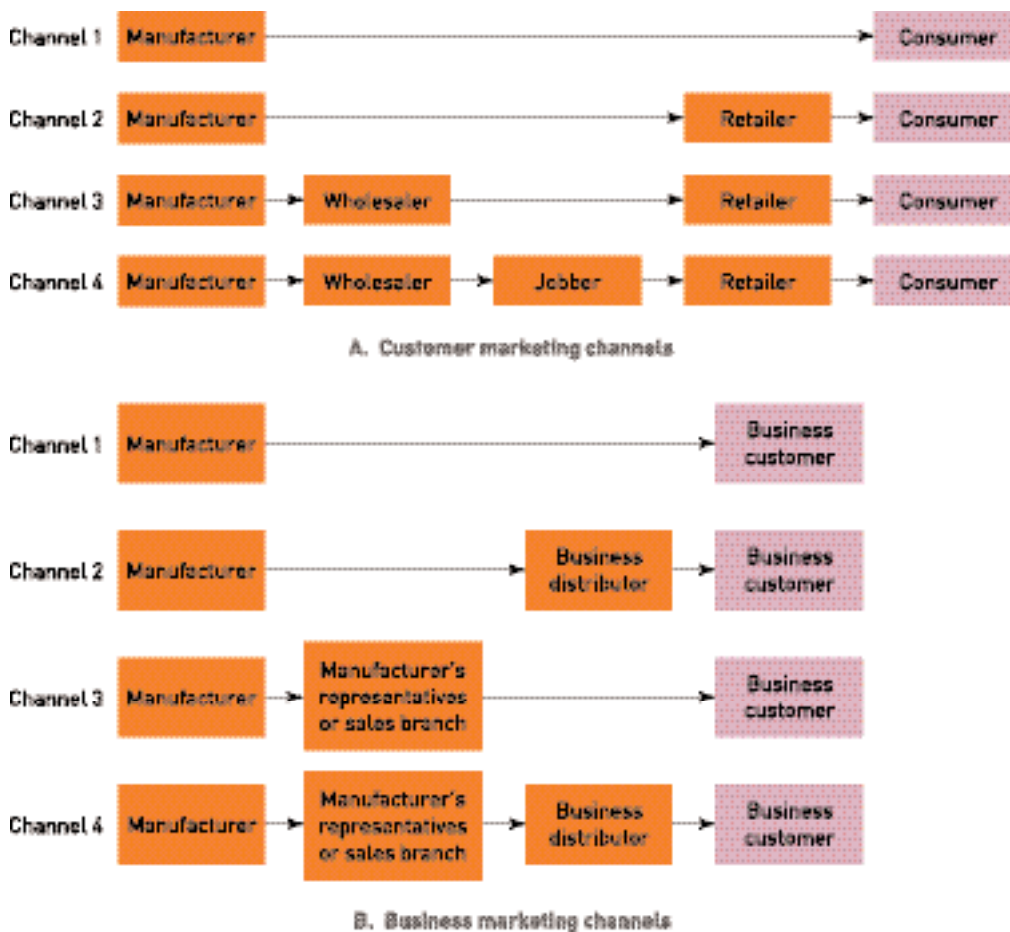


Figure 20.2 Consumer and business marketing channels

business marketer can use its own sales force to sell directly to business customers. Or it can sell to various types of intermediaries, who in turn sell to these customers. Consumer and business marketing channels with even more levels are sometimes found, but less often.

From the producer's point of view, a greater number of levels means less control and greater channel complexity. Moreover, all of the institutions in the channel are connected by several types of flows. These include the *physical flow* of products, the *flow of ownership*, the *payment flow*, the *information flow* and the *promotion flow*. These flows can make even channels with only one or a few levels very complex. The types of intermediary channel will be discussed in greater detail in a later section.

Channel behaviour and organisation

Distribution channels are more than simple collections of firms tied together by various flows. They are complex behavioural systems in which people and companies interact to accomplish individual, company and channel goals. Some channel systems consist only of informal interactions among loosely organised firms, while others consist of formal interactions guided by strong organisational structures. Moreover, channel systems do not stand still – new types of intermediary surface and whole new channel systems evolve. Here we look at channel behaviour and at how members organise to do the work of the channel.

Channel behaviour

A marketing channel consists of firms that have banded together and are dependent on each other to achieve a common goal. For example, a Peugeot dealer depends on the manufacturer to design cars that meet consumer needs. In turn, Peugeot depends on the dealer to attract consumers, persuade them to buy Peugeot cars, and service cars after the sale. The Peugeot dealer also depends on the other dealers to provide good sales and service that will uphold the reputation of Peugeot and its dealer body. In fact, the success of individual Peugeot dealers depends on how well the entire Peugeot marketing channel competes with the channels of other car manufacturers.

Each channel member plays a specialised role in the channel. For example, Philips' role is to produce consumer electronics products that consumers will like and to create demand through national, regional and worldwide advertising. The role of the specialist shops, department stores and other independent outlets that stock and sell Philips' products is to display these items in convenient locations, to answer buyers' questions, to close sales and to provide a good level of customer service. The channel will be most effective when each member is assigned the tasks it can do best.

Ideally, because the success of individual channel members depends on overall channel success, all channel firms should work together smoothly to secure healthy margins or profitable sales. They should understand and accept their roles, coordinate their activities and cooperate to attain overall channel goals. By cooperating, they can more effectively sense, serve and satisfy the target market. Unfortunately, individual channel members rarely take such a broad view. Cooperating to achieve overall channel goals sometimes means giving up individual company goals. Although channel members are dependent on one another, they often act alone in their own short-term best interests. They often disagree on the roles that each should play – that is, on who should do what and for what rewards. Such disagreements over goals, roles and rewards generate **channel conflict**. Conflict can occur at two levels.

Horizontal conflict is conflict among firms at the same level of the channel. For instance, Peugeot dealers in a particular geographic territory may complain that the other dealers in the territory steal sales from them by pricing too low or by selling outside their assigned territories.

Vertical conflict is more common and refers to conflicts between different levels of the same channel. For example, some personal computer manufacturers created conflict with their high street dealers when they opened online stores to sell PCs directly to customers. Dealers, not surprisingly, complained. To resolve the conflict, manufacturers had to develop communication campaigns to educate dealers on how online efforts would assist dealers rather than hurt sales.

Some conflict in the channel takes the form of healthy competition.

Channel conflict—

Disagreement among marketing channel members on goals and roles – who should do what and for what rewards.

Over the past five years, the toy company Lego opened a number of concept stores including licensed children's-wear stores, airport and other shopping stores throughout Europe, park stores in the UK, Denmark and the US, and United Nations-themed stores in the US. Lego management argued that the concept stores are about investing time and effort in inspiring high-street retailers – about setting a standard of retail innovation which ordinary retailers alone would not be able to achieve. Far from being inspired, many of Lego's current retailers objected to the potential impacts on their own businesses. Many were concerned about having to cut price to compete with the stores. Some felt they had been undervalued or devalued as Lego

stockists. Lego management were quick to reassure disgruntled channel members that the stores that offer a 'new retail experience' will not at all threaten customer traffic in the conventional retail outlets. The 'Lego store' is about building and sustaining a superior standard for the brand, which in turn promotes the esteem of the company's products for *all* Lego retailers. According to the company, Lego sales within a 50-mile radius of Legoland UK lifted after opening the park store. Lego product sales have risen above industry trends since its Minneapolis store opened. Besides, Lego's strategy has been to build an armoury of retailing experiences which would be transferred to its retail customers through franchise operations. Essentially, both manufacturer and retailer can satisfy consumers more effectively through building upon Lego's tradition for quality, heritage and innovation. ”

Such competition can be good for the channel – without it, the channel could become passive and non-innovative. But severe or prolonged conflict can disrupt channel effectiveness and cause lasting harm to channel relationships. Companies should manage channel conflict to keep it from getting out of hand.

For the channel as a whole to perform well, each channel member's role must be specified and channel conflict must be managed. The channel will perform better if it includes a firm, agency or mechanism that has the power to assign roles, secure channel cooperation and manage conflict. Let us take a look at how channel members organise to do the work of the channel.

Channel organisation

Historically, marketing channels have been loose collections of independent companies, each showing little concern for overall channel performance. These *conventional distribution channels* have lacked strong leadership and power, often resulting in damaging conflict and poor performance. One of the biggest recent channel developments has been the emergence of *vertical marketing systems* that provide channel leadership.

Vertical marketing systems

Figure 20.3 contrasts the two types of channel arrangement.

A **conventional distribution channel** consists of one or more independent producers, wholesalers and retailers. Each is a separate business seeking to maximise its own profits, even at the expense of profits for the system as a whole. No channel member has much control over the other members and no formal means exists for assigning roles and resolving channel conflict. In contrast, 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. The VMS can be dominated by the producer, wholesaler or retailer.

We now look at the three main types of VMS shown in Figure 20.4. Each type uses a different means for setting up leadership and power in the channel.

Corporate VMS

A **corporate VMS** combines successive stages of production and distribution under single ownership. Coordination and conflict management are attained through regular

Conventional distribution channel

—A channel consisting of one or more independent producers, wholesalers and retailers, each a separate business seeking to maximise its own profits, even at the expense of profits for the system as a whole.

Vertical marketing system (VMS)

—A distribution channel structure in which producers, wholesalers and retailers act as a unified system. One channel member owns the others, has contracts with them, or has so much power that they all cooperate.

Corporate VMS

—A vertical marketing system that combines successive stages of production and distribution under single ownership – channel leadership is established through common ownership.

Figure 20.3 A conventional marketing channel versus a vertical marketing system

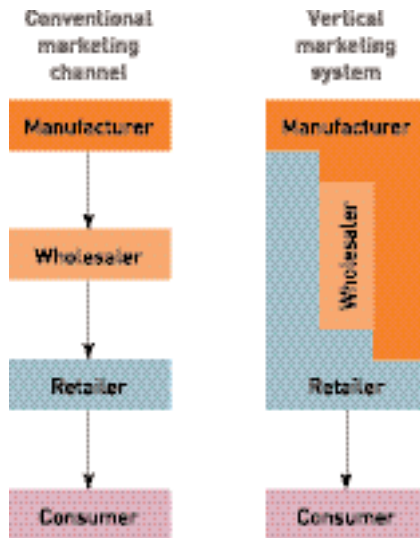
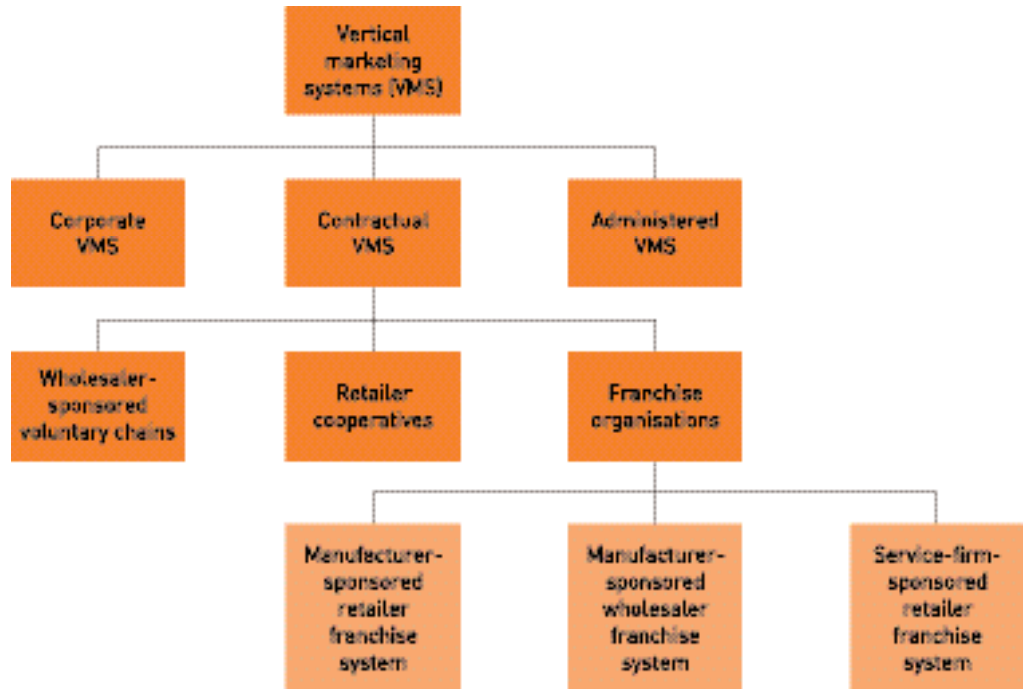


Figure 20.4 Main types of vertical marketing system



organisational channels. Petrol distribution through chains of petrol stations owned by the oil company is an example of delivery and control achieved by such a system. Breweries that sell beer through public houses under their ownership provide another example. Fashion retailers have also taken advantage of corporate VMS.

By controlling the entire distribution chain, Spanish clothing chain Zara turned into the world’s fastest-growing fashion retailer. The secret to Zara’s success is its control over almost every aspect of the supply chain, from design and production to its own worldwide distribution network. Zara makes 40 per cent

of its own fabrics and produces more than half of its own clothes, rather than relying on a hodgepodge of slow-moving suppliers. New styles take shape in Zara's own design centres, supported by real-time sales data. New designs feed into Zara manufacturing centres, which ship finished products directly to 450 Zara stores in 30 countries, saving time, eliminating the need for warehouses and keeping inventories low. Effective vertical integration makes Zara faster, more flexible and more efficient than international competitors such as Gap, Benetton and Sweden's H&M. Zara can make a new line from start to finish in just three weeks, so a look seen on TV can be in Zara stores within a month, versus an industry average of nine months. And Zara's low costs let it offer midmarket chic at downmarket prices. The company's stylish but affordable offerings have attracted a cult following, and the company's sales have more than doubled to some €2.3 billion in the past five years.³ ”

Contractual VMS

A **contractual VMS** consists of independent organisations at different levels of production and distribution who join together through contracts to obtain more economies or sales impact than each could achieve alone. Coordination and conflict management are attained through the legal arrangements agreed among channel members. There are three types of contractual VMS: wholesaler-sponsored voluntary chains, retailer cooperatives and franchise organisations.

In **wholesaler-sponsored voluntary chains**, wholesalers organise voluntary chains of independent retailers to help them compete with large chain organisations. The wholesaler develops a programme in which independent retailers standardise their selling practices and achieve buying economies that let the group compete effectively with chain organisations.

In **retailer cooperatives**, a group of independent retailers band together to own wholesale operations jointly, or to conduct joint wholesaling and possibly production. The Swiss Migros, with its dozen or so cooperatives, and the UK's Cooperative Societies take advantage of group buying and promotion economies through setting up such marketing arrangements. Members buy most of their goods through the retailer co-op and plan their advertising jointly. Profits are passed back to members in proportion to their purchases.

The **franchise** organisation is the most common of the three types of contractual relationship. In a franchise relationship, the franchiser links several stages in the production–distribution system. The franchiser typically provides a brand identity and start-up, marketing and accounting assistance as well as management know-how to the franchisee. In return, the franchiser gets some form of compensation, such as an initial fee and a continuing royalty payment, lease fees for equipment and a share of the profits. For example, the Hong Kong clothing group Esprit Holdings is built on a highly streamlined channel model under which it buys from third-party suppliers in China and sells to franchisees in its target markets throughout Europe, the USA and Asia, thereby minimising its own overheads.⁴ Franchising has been a fast-growing retailing form in recent years. Almost every kind of business has been franchised – from hotels and fast-food restaurants to dental and garden maintenance services, from wedding consultants and domestic services to funeral homes and fitness centres.

Franchising offers a number of benefits to both the franchiser and the franchisee. The main advantages for the franchiser are as follows:

- The franchiser secures fast distribution for its products and services without incurring the full costs of setting up and running its own operations. Franchising also enables the franchiser to expand a successful business more rapidly than by using its own capital.

Contractual VMS—A vertical marketing system in which independent firms at different levels of production and distribution join together through contracts to obtain more economies or sales impact than they could achieve alone.

Wholesaler-sponsored voluntary chains—Voluntary chains of independent retailers organised by the wholesaler to help them compete with large chain organisations.

Retailer cooperatives—Contractual vertical marketing systems in which retailers organise a new, jointly owned business to carry on wholesaling and possibly production.

Franchise—A contractual association between a manufacturer, wholesaler or service organisation (a franchiser) and independent businesspeople (franchisees) who buy the right to own and operate one or more units in the franchise system.

- The franchiser gets very highly motivated management as the franchisees are working for themselves rather than a salary.
- The contractual relationship ensures that franchisees operate to and maintain franchisers' standards.

The main advantages for franchisees are as follows:

- They are buying into a proven system if selling an established brand name (e.g. Esprit, McDonald's, Shell, The Body Shop, Interflora).
- They can start a business with limited capital and benefit from the experience of the franchiser. This way they reduce the costs and risks of starting a new business.
- Franchisees also get the benefits of centralised purchasing power – since the franchisers will buy in bulk for the franchisees.
- They get instant expertise in operational issues such as advertising, promotions, accounts and legal matters, and can rely on franchisers' help should things go wrong.

Franchise systems have several disadvantages:

- Franchisers invariably have to forfeit some control when operating through franchisees.
- The franchisees may not all perform exactly to franchisers' operating standards, and inconsistencies in service levels can tarnish the brand name.
- Franchisees may not always have a good deal, in that they have to work extremely hard to meet sales and financial targets to make the business pay, and although they have already paid their initial fee, they have to meet continuing management services or royalty payments.

There are three forms of franchise. The first form is the *manufacturer-sponsored retailer franchise system*, as found in the car industry. BMW, for example, licenses dealers to sell its cars; the dealers are independent businesspeople who agree to meet various conditions of sales and service. Shell, the oil company, adopts a franchising system on many of its petrol forecourts in countries around the world. The French designer garden furniture company Jardin en Plus has relied greatly on franchising to expand into other European markets.

The second type of franchise is the *manufacturer-sponsored wholesaler franchise system*, as found in the soft-drinks industry. Coca-Cola, for example, licenses bottlers (wholesalers) in various markets, which buy Coca-Cola syrup concentrate and then carbonate, bottle and sell the finished product to retailers in local markets. The third franchise form is the *service-firm-sponsored retailer franchise system*, in which a service firm licenses a system of retailers to bring its service to consumers. Examples are found in the car rental business (Hertz, Avis, Europcar), the fast-food service business (Deli France, McDonald's), the hotel business (Holiday Inn, Ramada Inn), and business-to-business services (see Marketing Insights 20.1).

The fact that most consumers cannot tell the difference between contractual and corporate VMSs shows how successfully the contractual organisations compete with corporate chains.

Administered VMS—

A vertical marketing system that coordinates successive stages of production and distribution, not through common ownership or contractual ties, but through the size and power of one of the parties.

Administered VMS

An **administered VMS** coordinates successive stages of production and distribution, not through common ownership or contractual ties, but through the size and power of one or a few dominant channel members. Manufacturers of a top brand can obtain strong trade cooperation and support from resellers. For example, in the fast-moving consumer-goods market, companies like Nestlé, Unilever and Procter & Gamble can command unusual cooperation from resellers regarding displays, shelf space, promotions and price policies. In the consumer electronics sector, Sony can obtain a great deal of trade support from retail stores for its top-selling brands. Similarly, large retailers like IKEA and Wal-Mart can exert strong influence on the manufacturers that supply the products they sell. Consider IKEA.

Mail Box Etc: signed, sealed and delivered

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Imagine you run a small business or you work from home. Wouldn't it be useful to have one person who takes care of all of your document printing, photocopying, packing, packaging, shipping and mailing needs? Indeed, for a growing number of businesses, the answer to this question is 'yes'. Many small and medium-sized companies are seeking to use a 'one-stop shop' that takes away the hassle by coordinating all these activities as well as providing a mail/parcel pick-up and delivery service any time of day. Mail Box Etc (MBE) offers just the solution.

Mail Box Etc hopes to have more of its one-stop-shops, where people can rent mail boxes, print out documents and do their photocopying, springing up on UK high streets soon – and it sees franchising as the way to do it. MBE has a total of 4,500 centres around the world, and is part of UPS, the world's largest package deliverer. The business began 23 years ago in the US – where it has recently been rebranded as 'The UPS Store'. It also has arms in Canada, Italy and elsewhere, operating under different master franchisers.

In Britain, it has 72 high street outlets, and it is looking to expand that number to about 300 main centres. 'We will eventually have a network that will be useable by the majority of the UK population', says Chris Gillam, managing director of MBE in the UK. 'It may include outlets in supermarkets and elsewhere, using a model that is slightly different from the current one.'

MBE specialises in three main areas. It rents out mail boxes, from which people can collect their mail or parcels at any time of the day or night, and it also operates a mail forwarding service. It operates a packing and shipping service that finds the appropriate carrier for a particular job. And the company also provides a photocopying and documents service.

MBE's customers tend to be small and medium-sized businesses, says Mr Gillam – and he points to the increasing number of people who run their own businesses or work from home for all or part of the week as a target market. Mr Gillam says he does not normally seek out potential franchisees – they tend to have an idea about going into franchising, perhaps developed through their bank or accountant, and then find out about Mail Boxes through the franchising press. MBE says its franchisees come from various walks of life – some have moved from financial services backgrounds, and others from sectors as diverse as catering and the armed services.

Although the company likes its new franchisees to have some previous experience in sales or management, it says this is not essential because it provides its own training. Mr Gillam – who is also on the governing board of the British Franchise Association – says one of the great benefits of franchising is that people can get a foothold in an area of business in which they have had no previous experience. Still,

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the start-up investment for a new MBE centre is some £85,000. About one-third of that is usually provided by the franchisee as liquid cash, while the rest is often borrowed through high street banks. A further working capital provision of between £10,000 and £20,000 is then needed, depending on the part of the country where the business is being set up. And once the new franchise is up and running, the links are maintained. 'We can do a great deal more in ongoing support and improved marketing', Mr Gillam says. MBE is appointing a new advertising agency and providing marketing materials to its franchisees. 'A lot of our business is aimed at small business', he adds. 'So we help franchisees come up with marketing material aimed at particular sectors.'

Those targeted sectors include solicitors and the hotel business. Once the franchisees have the information, they can then use their own databases to target suitable new clients. If, eventually, a franchisee wishes to leave the business – the franchise agreements are for 10 years – MBE also provides help in finding a new franchisee to take over. 'It's a bit like cradle to the grave', Mr Gillam jokes.

SOURCE: Lydia Adetunji, 'Mail Box Etc: New network of one-stop-shops', *Financial Times Special Report: Franchising* (4 June 2003), p. II.

In just over four decades, IKEA, the privately owned Swedish furniture and home furnishings group, grew from a single store in Sweden's backwoods to become one of the most successful international retailers in the world. By 2004, it had 165 stores in 25 countries around the world, excluding some 21 franchises, taking over €11.3 billion of sales in the year to 31 August 2003. Traditionally, selling furniture was a fragmented affair, shared between department stores and small family-owned shops. All sold expensive products and delivered up to two or three months after a customer's order. IKEA, however, sells most of its furniture as knocked-down kits for customers to take home and assemble themselves. IKEA also trims costs to a minimum while still offering products that are durable and distinguished by design and quality. It does this by using global sourcing, working with key suppliers around the world that can supply high-quality raw materials at low prices. In return these suppliers get technical advice and leased equipment from the company. IKEA's designers also work closely with manufacturers to find smart ways to reduce product costs from the outset. Other savings come from the huge economies of scale from operating in cheap out-of-town stores and from enormous production runs made possible by selling the same furniture all around the world. IKEA's success also means success for its suppliers. But they must operate to IKEA's terms and enable the global firm to fulfil its promise of quality merchandise at low cost to customers worldwide.⁵ ”



Firms can secure fast distribution for their products and services without incurring the full costs of setting up and running their own operations. Here, The Body Shop has successfully relied on franchising to expand its business rapidly.

SOURCE: The Body Shop International plc.

Horizontal marketing systems

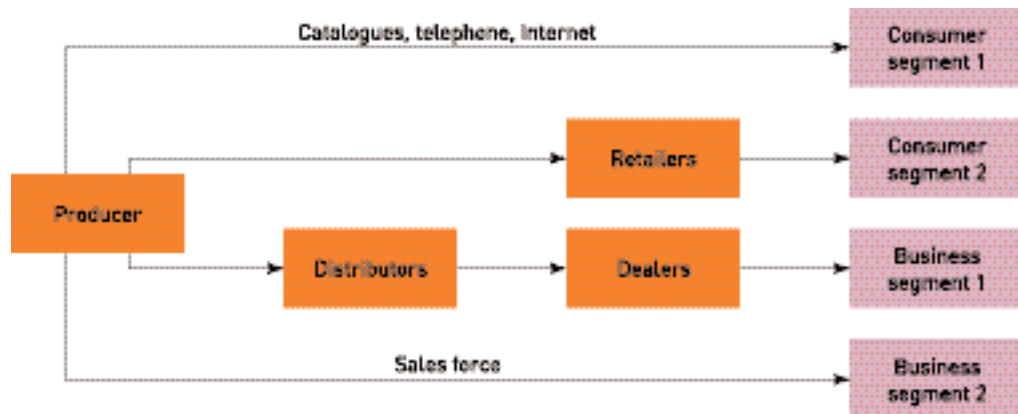
Another channel development is the **horizontal marketing system**, in which two or more companies at one level join together to follow a new marketing opportunity. By combining their capital, production capabilities or marketing resources, companies can accomplish more than any one company working alone.

Companies might join forces with competitors or non-competitors.⁶ They might work with each other on a temporary or permanent basis, or they may even create a separate company. Such channel arrangements also work well globally. For example, because of its excellent coverage of international markets, Nestlé jointly sells General Mills's cereal brands in markets outside North America. Coca-Cola and Nestlé formed a joint venture to market ready-to-drink coffee and tea worldwide. Coke provides worldwide experience in marketing and distributing beverages, and Nestlé contributes two established brand names – Nescafé and Nestea.

Horizontal marketing system

—A channel arrangement in which two or more companies at one level join together to follow a new marketing opportunity.

Figure 20.5 Hybrid marketing channel



Hybrid marketing systems

In the past, many companies used a single channel to sell to a single market or market segment. Today, with the proliferation of customer segments and channel possibilities, more and more companies have adopted *multi-channel distribution systems* – often called **hybrid marketing channels**. Such multi-channel marketing occurs when a single firm sets up two or more marketing channels to reach one or more customer segments.

Figure 20.5 shows a hybrid channel system. In the figure, the producer sells directly to consumer segment 1 using direct-mail catalogues, telemarketing and the Internet and reaches consumer segment 2 through retailers. It sells indirectly to business segment 1 through distributors and dealers, and to business segment 2 through its own sales force.

Sony maintains a wide distribution coverage by adopting a hybrid marketing system. For example, Sony sells its consumer products through exclusive retail outlets such as the Sony Centres, through mass merchandisers like electrical chain stores (e.g. Comet, Dixons) and catalogue shops (e.g. Index, Argos) and by using direct marketing channels, such as electronic and mail-order catalogues.

Multi-channel distribution systems offer many advantages to companies facing large and complex markets. With each new channel, the company expands its sales and market coverage, and gains opportunities to tailor its products and services to the specific needs of diverse customer segments. But such hybrid channel systems are harder to control, and they generate conflict as more channels compete for customers and sales. For example, when IBM began selling personal computers directly to customers at low prices through catalogues and telemarketing and its own website, many of its dealers cried ‘unfair competition’ and threatened to drop the IBM line or give it less emphasis. Many outside salespeople felt they were being undercut by the new ‘inside channels’.⁷

Changing channel organisation

Changes in technology and the explosive growth of direct and online marketing are having a profound impact on the nature and design of marketing channels. One major trend is towards **disintermediation** – a big term with a clear message and important consequences. Disintermediation means that more and more product and service producers are bypassing intermediaries and going directly to final buyers, or that radically new types of channel intermediaries are emerging to displace traditional ones.

Thus, in many industries, traditional intermediaries are dropping by the wayside. For example, companies like Dell Computer sell directly to final buyers, eliminating retailers from their marketing channels. E-commerce merchants are growing rapidly in number and size, displacing traditional bricks-and-mortar retailers. Today, consumers can buy flowers, books,

Hybrid marketing

channels—Multi-channel distribution, as when a single firm sets up two or more marketing channels to reach one or more customer segments. A variety of direct and indirect approaches are used to deliver the firm’s goods to its customers.

Disintermediation—

The elimination of a layer of intermediaries from a marketing channel or the displacement of traditional resellers by radically new types of intermediaries.

videos, CDs, toys, household products, groceries, clothes, consumer electronics and many other goods and services without ever visiting a store.

Disintermediation presents problems and opportunities for both producers and intermediaries. To avoid being swept aside, traditional intermediaries must find new ways to add value in the supply chain. To remain competitive, product and service producers must develop new channel opportunities, such as the Internet and other direct channels. However, developing these new channels often brings them into direct competition with their established channels, resulting in conflict. To ease this problem, companies often look for ways to make going direct a plus for both the company and its channel partners.

Going direct is rarely an all-or-nothing proposition. For example, to trim costs and add business, Hewlett-Packard opened three direct-sales websites: Shopping Village (for consumers), HP Commerce Centre (for businesses buying from authorised resellers) and Electronic Solutions Now (for existing contract customers). However, to avoid conflicts with its established reseller channels, HP forwards all its Web orders to resellers, who complete the orders, ship the products and get the commissions. In this way, HP gains the advantages of direct selling but also boosts business for resellers.⁸

Channel design decisions

We now look at several channel decisions facing manufacturers. In designing marketing channels, manufacturers struggle between what is ideal and what is practical. A new firm usually starts by selling in a limited market area. Deciding on the *best* channels might not be a problem: the problem might simply be how to convince one or a few good intermediaries to handle the line.

If successful, the new firm might branch out to new markets through existing intermediaries. In smaller markets, the firm might sell directly to retailers; in larger markets, it might sell through distributors. In one part of the country, it might grant exclusive franchises; 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 a local firm. Or it might add a Web store that sells directly to hard-to-reach customers. In this way, channel systems often evolve to meet market opportunities and conditions. However, for maximum effectiveness, channel analysis and decision making should be more purposeful. Designing a channel system calls for:

- Analysing customer service needs
- Defining the channel objectives and constraints
- Identifying the major channel alternatives
- Evaluating those alternatives.

Analysing customer service needs

We noted earlier that marketing channels are part of the overall *customer value delivery network* in which each channel member adds value for the customer. Thus designing the marketing channel starts with finding out what consumers want from the channel. Do customers want to buy from nearby locations or are they willing to travel to more distant, centralised locations? Would they rather buy in person or over the phone, through the mail or via the Internet? Do they value immediate delivery or are they willing to wait? Do they want breadth of assortment or do they prefer specialisation? Do customers want many add-on services (delivery, credit, repairs, installation) or will they obtain these elsewhere? The faster the delivery, the greater the assortment provided, and the more add-on services supplied, the greater the channel's service level.

However, providing the fastest delivery, greatest assortment and most comprehensive services may not be possible or practical. The company and its channel members may not have the resources or skills needed to provide all the desired services. Also, providing higher levels of service results not only in higher costs for the channel, but also in higher prices for consumers. The company must balance consumer service needs against the feasibility and costs of meeting these needs as well as customer price preferences. Generally, customers tend to make trade-offs between service quality and other purchase dimensions, such as price. The success of discount retailing – on and off the Web – shows that consumers are often willing to accept lower service levels in exchange for lower prices.

Setting channel objectives

Channel objectives should be stated in terms of targeted levels of customer service. The company can usually identify several segments wanting different levels of channel service. The company should decide which segments to serve and the best channels to use in each case. The company should aim to minimise the total channel cost of meeting customer service requirements.

The company's channel objectives are also influenced by the nature of the company, its products, its marketing intermediaries, competitors and the environment. For example, companies selling perishable products require more direct marketing to avoid delays and too much handling. The company's size and financial situation determine which marketing functions it can handle itself and which it must give to intermediaries. In some cases, a company may want to compete in or near outlets that carry competitors' products. Thus companies may want their brands to be displayed next to competing brands: in town or city centres, Burger King wants to locate near McDonald's; Sony, Panasonic and Philips audio and video systems all compete for floor space in similar retail outlets; Nestlé and Mars confectionery brands want to be positioned side by side, and aggressively compete for shelf space, in the same grocery outlets. In other cases, producers may avoid the channels used by competitors. Avon, for example, decided not to compete with other cosmetics makers for scarce positions in retail stores and, instead, set up a profitable door-to-door selling operation in the home and overseas markets. Finally, *environmental factors*, such as economic conditions and legal constraints, affect channel design decisions. For example, in a depressed economy, producers want to distribute their goods in the most economical way, using shorter channels and dropping unneeded services that add to the final price of the goods.

Identifying major alternatives

When the company has defined its channel objectives, it should next identify its major channel alternatives in terms of the *types* and *number* of intermediaries to use and the *responsibilities* of each channel member.

Types of channel alternatives

A number of options exist:

- *Direct marketing.* A number of direct marketing approaches can be used, ranging from direct-response selling via advertisements in print media, on radio or television, by mail order and catalogues to telephone and Internet selling. These methods are discussed in Chapter 19.
- *Sales force.* The company can sell directly through its own sales force or deploy another firm's sales force. Alternatively, a contract sales force might be used. The use of a company's direct sales force to sell to customers is discussed in Chapter 19.

Chapter 20 Managing marketing channels

- **Intermediaries.** Intermediaries are independent organisations that will carry out a number of activities. They include *wholesalers* and *retailers* who buy, take title to and resell the firm's goods. We will first address the nature of wholesalers.

Wholesalers

Wholesalers engage in wholesaling activity – selling goods and services to those buying for resale or business use. But why would a producer use wholesalers rather than selling directly to retailers or consumers? Quite simply, wholesalers add value by performing one or more of the following channel functions:

- **Selling and promoting.** Wholesalers' sales forces help manufacturers reach many small customers at a low cost. The wholesaler has many contacts and is often more trusted by the buyer than the distant manufacturer.
- **Buying and assortment building.** Wholesalers can select items and build assortments needed by their customers, thereby saving the consumers a considerable amount of work.
- **Bulk-breaking.** They save their customers money by buying in huge lots and breaking bulk (breaking large lots into small quantities).
- **Warehousing.** Wholesalers hold inventories, thereby reducing the inventory costs and risks of suppliers and customers.
- **Transportation.** Wholesalers can provide quicker delivery to buyers because they are closer than the producers.
- **Financing.** They finance their customers by giving credit, and they finance their suppliers by ordering early and paying bills on time.
- **Risk bearing.** Wholesalers absorb risk by taking title and bearing the cost of theft, damage, spoilage and obsolescence.
- **Market information.** They give information to suppliers and customers about competitors, new products and price developments.
- **Management services and advice.** Wholesalers often help retailers train their sales assistants, improve store layouts and displays, and set up accounting and inventory control systems.

There are many types of wholesaler (see Table 20.1). They fall into three major groups: *merchant wholesalers*, *brokers and agents* and *manufacturers' sales branches and offices*.

Merchant wholesalers include two broad types: full-service wholesalers and limited-service wholesalers. *Full-service wholesalers* provide a full set of services, whereas *limited-service wholesalers* offer fewer services to their suppliers and customers. The several different types of limited-service wholesalers perform varied specialised functions in the distribution channel.

Brokers and agents differ from merchant wholesalers. First, they do not take title to goods, and perform only a few functions. Like merchant wholesalers, they generally specialise by product line or customer type. A broker brings buyers and sellers together and assists in negotiation. Agents represent buyers or sellers on a permanent basis. Manufacturers' agents, also called manufacturers' representatives, are a common type of agent wholesaler.

The third type of wholesaling is that done in manufacturers' sales branches and offices by sellers or buyers themselves rather than through independent wholesalers.

Retailers

Although wholesalers play an important channel role, **retailers** are also critical intermediaries as they provide the final link between the consumer and provider. *Non-store retailing* has been growing much faster than has store retailing. Non-store retailing includes selling to final consumers through direct mail, catalogues, telephone, home TV shopping shows, home and office parties, door-to-door contact, vending machines, online services and the Internet, and

Intermediaries—Distribution channel firms that help the company find customers or make sales to them, including wholesalers and retailers that buy and resell goods.

Wholesaler—A firm engaged primarily in selling goods and services to those buying for resale or business use.

Merchant wholesaler—Independently owned business that takes title to the merchandise it handles.

Broker—A wholesaler who does not take title to goods and whose function is to bring buyers and sellers together and assist in negotiation.

Agent—A wholesaler who represents buyers or sellers on a relatively permanent basis, performs only a few functions, and does not take title to goods.

Retailers—Businesses whose sales come primarily from retailing.

Table 20.1 Major types of wholesalers

Type	Description
Merchant wholesalers	Independently owned businesses that take title to the merchandise they handle. In different trades they are called <i>jobbers</i> , <i>distributors</i> or <i>mill supply houses</i> . Include full-service wholesalers and limited-service wholesalers.
Full-service wholesalers	Provide a full line of services: carrying stock, maintaining a sales force, offering credit, making deliveries and providing management assistance. There are two types:
■ Wholesale merchants	Sell primarily to retailers and provide a full range of services. <i>General-merchandise wholesalers</i> carry several merchandise lines, whereas <i>general-line wholesalers</i> carry one or two lines in greater depth. <i>Speciality wholesalers</i> specialise in carrying only part of a line. Examples are healthfood wholesalers and seafood wholesalers.
■ Industrial distributors	Sell to manufacturers rather than to retailers. Provide several services, such as carrying stock, offering credit and providing delivery. May carry a broad range of merchandise, a general line or a speciality line.
Limited-service wholesalers	Offer fewer services than full-service wholesalers. Limited-service wholesalers are of several types:
■ Cash-and-carry wholesalers	Carry a limited line of fast-moving goods and sell to small retailers for cash. Normally do not deliver. For example, a small fish store retailer may drive to a cash-and-carry fish wholesaler, buy fish for cash and bring the merchandise back to the store.
■ Truck wholesalers (or truck jobbers)	Perform primarily a selling and delivery function. Carry a limited line of semi-perishable merchandise (such as milk, bread, snack foods), which they sell for cash as they make their rounds to supermarkets, small groceries, hospitals, restaurants, factory cafeterias and hotels.
■ Drop shippers	Do not carry inventory or handle the product. On receiving an order, they select a manufacturer, who ships the merchandise directly to the customer. The drop shipper assumes title and risk from the time the order is accepted to its delivery to the customer. They operate in bulk industries, such as coal, lumber and heavy equipment.
■ Rack jobbers	Serve grocery and drug retailers, mostly in non-food items. They send delivery trucks to stores, where the delivery people set up toys, paperbacks, hardware items, health and beauty aids, or other items. They price the goods, keep them fresh, set up point-of-purchase displays and keep inventory records. Rack jobbers retain title to the goods and bill the retailers only for the goods sold to consumers.
■ Producers' cooperatives	Owned by farmer members and assemble farm produce to sell in local markets. The co-op's profits are distributed to members at the end of the year. They often attempt to improve product quality and promote a co-op brand name.
■ Mail-order wholesalers	Send catalogues to retail, industrial and institutional customers. Maintain no outside sales force. Orders are filled and sent by mail, truck or other transportation.
Brokers and agents	Do not take title to goods. Their main function is to facilitate buying and selling, for which they earn a commission on the selling price. Generally, they specialise by product line or customer types.
Brokers	Their chief function is bringing buyers and sellers together and assisting in negotiation. They are paid by the party who hired them, and do not carry inventory, get involved in financing or assume risk. Examples are food brokers, real estate brokers, insurance brokers and security brokers.
Agents	Represent either buyers or sellers on a more permanent basis than brokers do. There are several types:
■ Manufacturers' agents	Represent two or more manufacturers of complementary lines. A formal written agreement with each manufacturer covers pricing, territories, order handling, delivery service and

Table 20.1 (cont'd)

Type	Description
<ul style="list-style-type: none"> ■ Selling agents 	<p>warranties, and commission rates. Often used in such lines as clothing, furniture and electrical goods. Most manufacturers' agents are small businesses, with only a few skilled salespeople as employees. They are hired by small manufacturers who cannot afford their own field sales forces, and by large manufacturers who use agents to open new territories or to cover territories that cannot support full-time salespeople.</p> <p>Have contractual authority to sell a manufacturer's entire output. The manufacturer either is not interested in the selling function or feels unqualified. The selling agent serves as a sales department and has significant influence over prices, terms and conditions of sale.</p>
<ul style="list-style-type: none"> ■ Purchasing agents 	<p>Generally have a long-term relationship with buyers and make purchases for them, often receiving, inspecting, warehousing and shipping the merchandise to the buyers. They provide helpful market information to clients and help them obtain the best goods and prices available.</p>
<ul style="list-style-type: none"> ■ Commission merchants 	<p>Take physical possession of products and negotiate sales. Normally, they are not employed on a long-term basis. Used most often in agricultural marketing by farmers who do not want to sell their own output and do not belong to producers' cooperatives. The commission merchant takes a truckload of commodities to a central market, sells it for the best price, deducts a commission and expenses and remits the balance to the producer.</p>
<ul style="list-style-type: none"> ■ Manufacturers' and retailers' branches and offices 	<p>Wholesaling operations conducted by sellers or buyers themselves rather than through independent wholesalers. Separate branches and offices can be dedicated to either sales or purchasing:</p> <ul style="list-style-type: none"> ■ <i>Sales branches and offices</i> are set up by manufacturers to improve inventory control, selling and promotion. Sales branches carry inventory. Sales offices do not carry inventory. ■ <i>Purchasing offices</i> perform a role similar to that of brokers or agents but are part of the buyer's organisation. Retailers tend to set up purchasing offices in major market centres.

other direct retailing approaches. We discussed traditional, non-store or direct-marketing channels in Chapter 19, while Chapter 4 addressed online marketing tools. In this chapter, we will focus on store retailing.

Retail stores come in all shapes and sizes, and new retail types keep emerging. Generally, they can be distinguished by the amount of service they offer, the breadth and depth of their product lines, the relative prices charged and how they are organised.

Amount of service Different products require *different amounts of service* and *customer service preferences* vary. **Self-service retailers** cater for customers who are willing to perform their own 'locate–compare–select' process to save money. Self-service is the basis of all discount operations and is typically used by sellers of convenience goods (e.g. supermarkets) and nationally branded, fast-moving shopping goods (e.g. discount stores). **Limited-service retailers**, such as department stores, provide more sales assistance because they carry more shopping goods about which customers need information. **Full-service retailers**, such as speciality stores and up-market department stores, assist customers in every phase of the shopping process. They usually carry more speciality goods, for which customers like to be 'waited on'. They provide more services, resulting in much higher operating costs, which are invariably passed along to customers as higher prices.

Product line Retailers vary in the *length and breadth of their product assortments*. A **speciality store** carries a narrow product line with a deep assortment within that line. Examples are

Self-service retailers—

Retailers that provide few or no services to shoppers; shoppers perform their own locate–compare–select process.

Limited-service retailers—

Retailers that provide only a limited number of services to shoppers.

Full-service retailers—

Retailers that provide a full range of services to shoppers.

Speciality store—

A retail store that carries a narrow product line with a deep assortment within that line.

stores selling fashion wear, outdoor leisure garments, cosmetics, books or flowers (e.g. Naf-Naf, Rohan, The Body Shop, Foyles, Interflora). Today, speciality stores are flourishing for several reasons. The increasing use of market segmentation, market targeting and product specialisation has resulted in a greater need for specialist stores that focus on specific products and segments.

Department store—A retail organisation that carries a wide variety of product lines – typically clothing, home furnishings and household goods; each line is operated as a separate department managed by specialist buyers or merchandisers.

Convenience store—A small store located near a residential area that is open long hours seven days a week and carries a limited line of high-turnover convenience goods.

In contrast, **department stores** carry a wide variety of product lines. Examples of well-known department stores are Harrods and Harvey Nichols (in the United Kingdom), Takashimaya and Isetan (in Japan and south-east Asia), Saks and Bloomingdale (in the United States), El Corte Ingles (in Spain), Galeries Lafayette (in France) and Karlstadt (in Germany). In recent years, department stores have been squeezed between more focused and flexible speciality stores on the one hand, and more efficient, low-priced discounters on the other. In response, many have added promotional pricing to meet the discount threat. Others have increased the use of store brands and single-brand ‘boutiques’ and ‘designer shops’ (such as Dolce and Gabbana, Salvatore Ferragamo or DKNY shops within department stores) to compete with speciality stores. Still others are trying mail-order, telephone or Web selling. Service, invariably, remains the key differentiating factor.

Convenience stores are small stores that carry a limited line of high-turnover convenience goods. Typical examples are Happy Shopper, Spar, Mace and VG stores. These are located near residential areas and remain open for long hours. In countries where retail laws are more relaxed and there is less restriction in store opening hours, convenience stores may be open seven days a week. They satisfy an important consumer need in a niche segment – shoppers in this segment use convenience stores for emergency or ‘fill-in’ purchases outside normal hours or when time is short, and they are willing to pay for the convenience of location and opening hours.

In the UK, analysts believe that the convenience store market could grow between 30 and 60 per cent between 2003 and 2007. The sector is fragmented, boasting 50,000 stores, with independently owned outlets accounting for more than 40 per cent of sales. More and more people appear to prefer to visit their local (neighbourhood) convenience store to do top-up shopping because they do not have time every day to browse endless supermarket shelves to find lunch or dinner. The major supermarket chain stores are responding to this trend.

Britain’s number one grocery retailer Tesco has become the second biggest convenience retailer, behind the Co-operative Group, who owns Alldays, through its purchase of 862 T&S stores in October 2002. Rebranded Tesco Express, these stores could change the pattern of grocery retailing in the country. Tesco also operates a partnership with Esso and runs some 100 stores on the petrol retailer’s forecourts. Meanwhile, rival Sainsbury is aiming to grab a larger slice of the growing UK convenience store market with plans to open 100 or more stores at Shell petrol filling stations over 2003–2006, in addition to its existing 52 stand-alone ‘Local’ convenience stores network. According to Sainsbury, measured by sales per square foot, 11 of its top 20 performing stores were local, neighbourhood stores and three of them were on Shell forecourts. As opportunities for large store expansion out-of-town in the UK are declining because of planning restrictions, we will witness more and more marriages between petrol retailers and supermarkets.⁹ ”

Supermarkets—Large, low-cost, low-margin, high-volume, self-service stores that carry a wide variety of food, laundry and household products.

Supermarkets are the most frequently shopped type of retail store. Today, however, they are facing slow sales growth because of an increase in competition from convenience stores,

discount food stores and superstores. Thus, supermarkets have to make improvements to attract more customers. In the battle for 'share of stomachs', some of the larger supermarkets, for example, have moved up-market, providing in-store bakeries, gourmet deli counters and fresh seafood departments. Others are cutting costs, establishing more efficient operations and lowering prices in order to compete more effectively with food discounters. As we saw earlier, some like Tesco and Sainsbury are seeking to widen their presence in the local store market.

Superstores are much larger than regular high street supermarkets and offer a large assortment of routinely purchased food products, non-food items and services, ranging from dry cleaning, post offices and film developing and photo finishing, to cheque cashing, petrol forecourts and self-service car-washing facilities. Superstores are located out of town, frequently in retail parks, with vast free car parks. The 1990s saw the explosive growth of superstores that are actually giant speciality stores, the so-called **category killers**. They feature stores the size of aircraft hangars that carry a very deep assortment of branded products belonging to a particular line, with a knowledgeable staff. Category killers have been prevalent in a wide range of categories, including books, toys, electronics, furniture, home improvement products, sporting goods and even pet supplies.

Another superstore variation, **hypermarkets**, are even bigger, perhaps as large as six football fields. They carry an even larger assortment of routinely purchased food and packaged goods and non-food items such as clothing, furniture and household appliances. Carrefour, the number one grocery retailer in France, opened the world's first 'hypermarket' at Ste-Geneviève-des-Bois, near Paris, in 1963. Since then, the concept quickly took off in France and the company now operates hundreds of these giant stores in Europe, South America and Asia. Other examples of hypermarkets include Real in Germany, Pycra in Spain and Meijers in the Netherlands. Although hypermarkets have dominated in some countries, such as France, Italy and the Netherlands, the concept has enjoyed mixed success in the UK. Those that tried in the UK – Sainsbury's Savacentres, Asda and Tesco Extra – invested heavily to make the stores look nice and to offer additional facilities such as crèches, cafés and carefully designed car parks.¹⁰

Relative prices Retailers can also be classified according to the prices they charge. Most retailers charge regular prices and offer normal-quality goods and customer service. Others offer higher-quality goods and services at higher prices. The retail stores that feature low prices are discount stores and off-price retailers.

A **discount store** sells standard merchandise at lower prices by accepting lower margins and selling higher volume. Examples include the German Aldi, the Danish Netto, the French Carrefour, and Matalan and Peacock in the UK. The early discount stores cut expenses by offering few services and operating in warehouse-like facilities in low-rent, heavily travelled districts. In recent years, facing intense competition from other discounters and department stores, many discount retailers have 'traded up'. They have improved décor, added new lines and services and opened suburban branches, which have led to higher costs and prices.

When the major discount stores traded up, a new wave of **off-price retailers** moved in to fill the low-price, high-volume gap. Ordinary discounters buy at regular wholesale prices and accept lower margins to keep prices down. In contrast, off-price retailers buy at less-than-regular wholesale prices and charge consumers less than retail. One type of off-price retailer is the factory outlet. **Factory outlets** sometimes group together in *factory outlet malls* and *value-retail centres*, where dozens of outlet stores offer prices 30–50 per cent below retail on a wide range of items. Whereas outlet shopping centres consist primarily of manufacturers' outlets, value-retail centres combine manufacturers' outlets with off-price retail stores and department store clearance outlets. Factory outlet stores have recently taken off. Even retailers such as Marks & Spencer now offer a mix of slow-selling stock, ranges from the

Superstore—A store around twice the size of a regular supermarket that carries a large assortment of routinely purchased food and non-food items and offers such services as dry cleaning, post offices, film developing, photo finishing, cheque cashing, petrol forecourts and self-service car-washing facilities.

Category killers—A modern 'breed' of exceptionally aggressive 'off-price' retailers that offer branded merchandise in clearly defined product categories at heavily discounted prices.

Hypermarkets—Huge stores that combine supermarket, discount and warehouse retailing; in addition to food, they carry furniture, appliances, clothing and many other products.

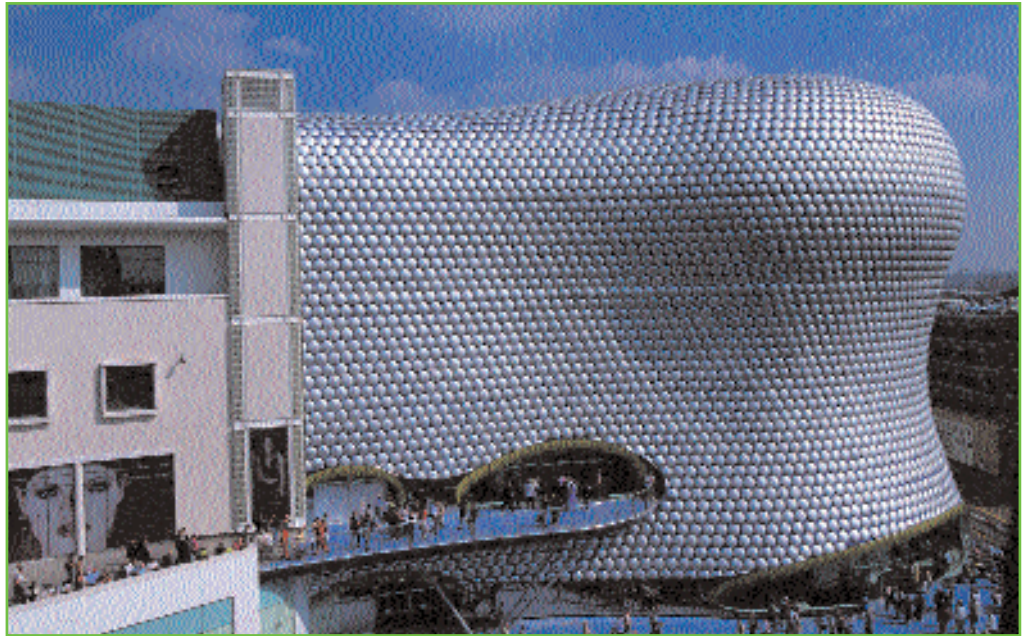
Discount store—A retail institution that sells standard merchandise at lower prices by accepting lower margins and selling at higher volume.

Off-price retailer—Retailer that buys at less-than-regular wholesale prices and sells at less than retail.

Factory outlet—Off-price retailing operation that is owned and operated by a manufacturer and that normally carries the manufacturer's surplus, discontinued or irregular goods.

Bullring: standing in the heart of Birmingham, Britain's second largest city, the Bullring shopping centre is one of Europe's largest and most innovative shopping destinations, housing two major department stores, Selfridges and Debenhams, and well over 140 shops, restaurants and bars. New shopping concepts like this offer a brand new experience for shoppers.

SOURCE: (both) Birmingham Photo Library/Jonathan Berg.



Chapter 20 Managing marketing channels

previous season and items specifically manufactured for factory outlets. A growing number of factory outlets typically feature designer brands such as Versace, Donna Karan, Esprit and Calvin Klein, causing department stores to protest to the manufacturers of these brands.¹¹

Another off-price retail format is the **warehouse club** (also known as **wholesale club** or **membership warehouse**), which operates in huge, draughty, warehouse-like facilities and offers few frills. Customers themselves must wrestle furniture, heavy appliances and other large items to the checkout line. Such clubs make no home deliveries. The policy is 'cash and carry' as they accept no credit cards, but they do offer ultra-low prices and surprise deals on selected branded goods. For example, the German-owned Makro operates vast warehouses across Europe, selling food, beverages, wines and spirits, confectionery, household goods, clothes and other assortments to members – consumers and trade (resellers/retailers) who pay a membership fee. Warehouse clubs saw tremendous growth over the 1980s, but growth has slowed considerably in the 1990s as a result of increasing competition among warehouse store chains and effective reactions by supermarkets and discount stores.

Organisational approach Although many retail stores are independently owned, an increasing number are banding together under some form of corporate or contractual organisation. The major types of retail organisations include *corporate chains*, *voluntary chains* and *retailer cooperatives*, *franchise organisations* and *merchandising conglomerates*.

Chain stores are two or more outlets that are commonly owned and controlled. Their size allows them to buy in large quantities at lower prices and gain promotional economies. They can hire specialists to deal with pricing, promotion, merchandising, inventory control and sales forecasting.

The great success of corporate chains caused many independents to band together in one of two forms of contractual associations. One is the *voluntary chain* – a wholesaler-sponsored group of independent retailers that engages in group-buying and common merchandising. The other form of contractual association is the *retailer cooperative* – a group of independent retailers that band together to set up a jointly owned, central wholesale operation and conduct joint merchandising and promotion efforts. These organisations give independents the buying and promotion economies they need to meet the prices of corporate chains.

Another form of contractual retail organisation is a franchise. The main difference between franchise organisations and other contractual systems (voluntary chains and retail cooperatives) is that franchise systems are normally based on some unique product or service, on a method of doing business, or on the trade name, goodwill or patent that the franchiser has developed. Franchising, which we discussed in an earlier section, has been prominent in fast food, fashion clothing, video stores, health and fitness centres, haircutting, vehicle hire, hotels and dozens of other product and service areas.

Finally, *merchandising conglomerates* are corporations that combine several different retailing forms under central ownership. Examples include Arcadia and the Kingfisher Group. Arcadia operates Principles (middle- to upmarket clothing for professional men and women), Dorothy Perkins (middle-market apparel for younger females), Top Shop (high fashion, mid-priced clothing for the young, trendy segment), and Evans (larger-sized clothing or outsizes for the older female). The Kingfisher Group owns numerous speciality chains and variety chain stores, including B&Q (do-it-yourself, DIY store), Comet (electrical and home appliances), Superdrug (discount toiletries), Charlie Brown's (vehicle spare parts and accessories), and Woolworth's (general merchandise and variety store). Diversified retailing, which provides superior management systems and economies that benefit all the separate retail operations, is likely to increase in the new millennium.

We have discussed the types of channel members. Next we look at decisions concerning the number of channels to use.

Warehouse club (wholesale club, membership warehouse)—Off-price retailer that sells a limited selection of brand-name grocery items, appliances, clothing and a hodgepodge of other goods at deep discounts to members who pay annual membership fees.

Number of marketing intermediaries

Companies must also decide on *channel breadth* – the number of channel members to use at each level. Three strategies are available: intensive distribution, exclusive distribution and selective distribution. Producers of convenience products and common raw materials typically seek **intensive distribution** – a strategy whereby they stock their products in as many outlets as possible. These goods must be available where and when consumers want them. For example, sweets, chewing gum, disposable razors, soft drinks and other similar items are sold in myriad outlets to provide maximum brand exposure and consumer convenience. Nestlé, Bic, Coca-Cola and many consumer-goods companies distribute their products in this way.

By contrast, some producers purposely limit the number of intermediaries handling their products. The extreme form of this practice is **exclusive distribution**, in which the producer gives only a limited number of dealers the exclusive rights to distribute its products in their territories. Exclusive distribution is often found in the distribution of luxury cars (e.g. Rolls-Royce, Jaguar) and prestige clothing for men and women (e.g. Giorgio Armani, Prada, Yves St Laurent). By granting exclusive distribution, the manufacturers gain strong selling support from the outlet and more control over dealer prices, promotion, credit and services. Exclusive distribution also enhances brand image and allows for higher mark-ups.

Between intensive and exclusive distribution lies **selective distribution** – the use of more than one, but fewer than all of the intermediaries that are willing to carry a company's products. Most electronic products, furniture and small household appliance brands are distributed in this manner. For example, Miele, Whirlpool and AEG sell their major appliances through dealer networks and selected large retailers. By using selective distribution, they do not have to spread their efforts over many outlets, including many marginal ones. They can develop good working relationships with selected channel members and expect a better-than-average selling effort. Selective distribution gives producers good market coverage with more control and less cost than does intensive distribution.

Intensive distribution—

Stocking the product in as many outlets as possible.

Exclusive distribution—

Giving a limited number of dealers the exclusive right to distribute the company's products in their territories.

Selective distribution—

The use of more than one, but less than all of the intermediaries that are willing to carry the company's products.

Responsibilities of channel members

The producer and its 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. The producer should establish a list price and a fair set of discounts for intermediaries. It must define each channel member's territory, taking care where it places new resellers. Mutual services and duties need to be spelled out carefully, especially in franchise and exclusive distribution channels.

Evaluating the main alternatives

Once a company has identified several channel alternatives, it has to select the one that will best satisfy its long-run objectives. The firm must evaluate each alternative against *economic*, *control* and *adaptive* criteria.

Using economic criteria, the company compares the likely profitability of different channel alternatives. It estimates the sales that each channel would produce and the costs of selling different volumes through each channel. The company must also consider control issues. Using intermediaries usually means giving them some control over the marketing of the product, and some intermediaries take more control than others. Other things being equal, the company prefers to keep as much control as possible. Finally, the company must apply adaptive criteria. Channels often involve long-term commitments, yet the company wants to keep the channel flexible so that it can adapt to environmental changes. Thus, to be considered, a channel involving long-term commitment should be greatly superior on economic or control grounds.

Designing international distribution channels

International marketers face many additional complexities in designing their channels. Each country has its own unique distribution system that has evolved over time and changes very slowly. For instance, in food and drinks retailing, contract distributors play a more important role in the delivery of goods from producer to retailer in the United Kingdom than in countries such as Germany, France, Spain and Italy. Also, multiple retailer dominance of the grocery market is more pervasive in the United Kingdom than in the latter countries. Thus global marketers must usually adapt their channel strategies to the existing structures within each country.

International logistics are becoming an increasingly important area for global businesses whose inbound supply movements are shifting from domestic sources to global ones, and whose outbound supplies face an equally international trade flow. Sophisticated computer-based technologies, such as computer-integrated logistics (CIL), are used to enable international companies and logistics service providers to manage the supply chain and specific logistics functions. International logistics place even greater demands on good integration of logistics operations and systems between the suppliers, manufacturer and others involved in moving supplies or goods along the supply chain across national borders.

In some overseas markets, the distribution system is complex and hard to penetrate, consisting of many layers and large numbers of intermediaries. For example, in Japan, the distribution system encompasses a wide range of wholesalers, agents, brokers and retailers, differing more in number than in function from their European or American counterparts.¹²

Many western firms have had great difficulty breaking into the closely knit, tradition-bound Japanese distribution network. For example, when the French retail group Carrefour entered the Japanese market in December 2000, it faced hostility from wholesalers. Carrefour's pricing demands and refusal to accept the multi-layered supply system sometimes left it struggling to maintain stocks.¹³ However, Japan's archaic 'Large Scale Retail Law', which controlled planning permission for new stores and opening hours to protect small retailers from new high-street competitors, has been deregulated. Retailing law reforms have enabled



The Japanese distribution system has remained remarkably traditional. A profusion of tiny retail shops are supplied by an even greater number of small wholesalers.

SOURCE: Stock Boston/Charles Gupton.

foreign retailers, ranging from Boots and The Body Shop to IKEA and Toys 'R' Us, to break the links between the manufacturers and the high-street stores.¹⁴

At the other extreme, distribution systems in developing countries may be scattered and inefficient, or altogether lacking. For example, although China and India each contain hundreds of millions of people, these markets are much smaller than the population numbers suggest. Their inadequate distribution systems mean that most companies can profitably access only the small portion of the population living in the most affluent cities.¹⁵

Thus international marketers face a wide range of channel alternatives. Designing efficient and effective channel systems between and within various country markets poses a difficult challenge.

Channel management decisions

Once the company has reviewed its channel alternatives and decided on the best channel design, it must implement and manage the chosen channel. Channel management calls for selecting and motivating individual channel members and evaluating their performance over time.

Selecting channel members

Producers vary in their ability to attract qualified marketing intermediaries. Some producers have no trouble signing up channel members. In some cases, the promise of exclusive or selective distribution for a desirable product will draw plenty of applicants. At the other extreme are producers that have to work hard to line up enough qualified intermediaries. When household group Reckitt launched its new 'green' detergent brand, Down to Earth, in the UK market, access was restricted to one supermarket chain – Tesco. The Belgian firm Ecover managed to acquire sole rights for distribution in Asda stores and in Sainsbury, Safeway and the Co-op when it launched its radical 'green' detergents at the height of green consumerism in the United Kingdom. Many small food and grocery producers that own marginal brands often have difficulty getting retailers to carry their products.

When selecting intermediaries, the company should determine what characteristics distinguish the better ones. It will want to evaluate the channel members' years in business, other lines carried, growth and profit record, level of cooperation and reputation. If the intermediaries are sales agents, the company will want to evaluate the number and character of other lines carried and the size and quality of the sales force. If the intermediary is a retail store that wants exclusive or selective distribution, the company will want to evaluate the store's customers, location and future growth potential.

Managing and motivating channel members

Channel members must be continuously motivated to do their best. The company must sell not only *through* the intermediaries, but *to* and *with* them. More advanced companies see their intermediaries as first-line customers and partners. They practise strong *partner relationship management (PRM)* to forge long-term partnerships with channel members. This creates a marketing system that meets the needs of both the company *and* its partners.

In managing its channels, a company must convince distributors that they can succeed better by working together as a part of a cohesive value delivery system.¹⁶ Thus, manufacturers such as Unilever and P&G work together with grocery retailers to create superior value for final consumers. They jointly plan merchandising goals and strategies, inventory levels and advertising and promotion plans. Similarly, construction equipment manufacturer JCB and

automobile producers such as Ford and Toyota have to work closely with their dealers to help them to be successful in selling the company's products.

Many companies are now installing high-tech partner relationship management systems to coordinate their whole-channel marketing efforts. Just as they use customer relationship management (CRM) software systems to help manage relationships with important customers, companies can now use PRM software to help recruit, train, organise, manage, motivate and evaluate relationships with channel partners.¹⁷

Evaluating channel members

The producer must regularly check channel member performance against agreed targets such as sales quotas, average inventory levels, customer delivery time, treatment of damaged and lost goods, cooperation in company promotion and training programmes, and services to the customer. The company should recognise and reward intermediaries that are performing well. Those which are underperforming should be helped, remedial actions should be taken or, as a last resort, the intermediary should be replaced. The firm must periodically 'requalify' its intermediaries and prune the weak performers, allowing only the best ones to carry its products.

Finally, manufacturers need to be sensitive to their dealers. Those who treat their dealers poorly risk not only losing their support, but also causing legal problems. Disputes with dealers are counterproductive. The key to profitable channel management lies in creating win-win outcomes for all in the value delivery network – a mutually beneficial relationship that yields cooperation, not conflict, among channel participants will invariably result in higher channel performance.

Marketing logistics and supply chain management

In today's global marketplace, selling a product is sometimes easier than physically getting it to customers. Companies must decide on the best way to store, handle and move their products and services, so that they are available to customers in the right assortments, at the right time and in the right place. Physical distribution and logistics effectiveness will have a significant impact on both customer satisfaction and company costs. A poor distribution system can destroy an otherwise good marketing effort. Here we consider the nature and importance of *marketing logistics*, goals of the *logistics system*, *major logistics functions*, *choosing transportation modes* and the importance of *integrated logistics management*.

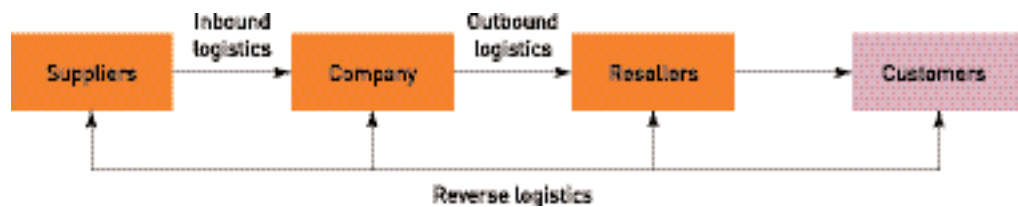
The nature and importance of marketing logistics

To some managers, physical distribution means only trucks and warehouses. But modern logistics is much more than this. **Physical distribution** or **marketing logistics** involves planning, implementing and controlling the physical flow of materials, final goods and related information from points of origin to points of consumption to meet customer requirements at a profit. In short, it involves getting the right product to the right customer in the right place at the right time.¹⁸

Traditional physical distribution has typically started with products at the plant and tried to find low-cost solutions to get them to customers. However, today's marketers prefer *customer-centred logistics* thinking which starts with the marketplace and works backwards to the factory or even to sources of supply. Marketing logistics addresses not only *outbound*

Physical distribution (marketing logistics)—The tasks involved in planning, implementing and controlling the physical flow of materials and final goods from points of origin to points of use to meet the needs of customers at a profit.

Figure 20.6 Supply chain management



distribution (moving products from the factory to customers), but also *inbound distribution* (moving products and materials from suppliers to the factory) and *reverse distribution* (moving broken, unwanted or excess products returned by consumers and resellers). In short, it involves entire *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, as shown in Figure 20.6. Thus the logistics manager’s task is to coordinate the whole channel physical distribution system – the activities of suppliers, purchasing agents, marketers, channel members and customers. These activities include forecasting, purchasing, production planning, order processing, inventory management, warehousing and transportation planning.

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

- Customer service and satisfaction have become the cornerstones of marketing strategy in many businesses, and distribution is an important customer service element. Companies can gain a powerful competitive advantage by using improved logistics to give customers faster delivery, better service or lower prices.
- Improved logistics can yield tremendous cost savings to both the company and its customers. About 15 per cent of an average product’s price is accounted for by shipping and transport alone.
- The explosion in product variety has created a need for improved logistics management. For example, 100 years ago, a typical grocery store carried only 200–300 items. The store manager could keep track of this inventory on about 10 pages of notebook paper stuffed in a shirt pocket. Today, the average store carries a bewildering stock of 10,000 to 20,000 items. Ordering, shipping, stocking and controlling such a variety of products presents a sizeable logistics challenge.
- Finally, improvements in information technology have created opportunities for improving distribution efficiency. The increased use of sophisticated supply chain management software, Web-based logistics systems, point-of-sale scanners, uniform product codes, satellite tracking and electronic transfer of order and payment data, enables companies to manage the flow of goods, information and finances through the supply chain quickly and efficiently.

Goals of the logistics system

The starting point for designing a marketing logistics system is to study the service needs of customers. Some companies state their logistics objective as providing maximum customer service at the least cost. Unfortunately, no logistics system can *both* maximise customer service *and* minimise distribution costs. Maximum customer service implies rapid delivery, large inventories, flexible assortments, liberal returns policies and a host of other services – all of which raise distribution costs. In contrast, minimum distribution cost implies slower delivery, small inventories and larger shipping lots – which represent a lower level of overall customer service.

The goal of the marketing logistics system should be to provide *a targeted level of customer service at the least cost*. The company must first research the importance of various distribution services that customers require and then set desired service levels for each

segment. The objective is to maximise *profits*, not sales. Therefore, the company must weigh the benefits of providing higher levels of service against the costs. Some companies offer less service than their competitors and charge a lower price. Other companies offer more service and charge higher prices to cover higher costs.

Major logistics functions

Given a set of logistics objectives, the company is ready to design a logistics system that will minimise the cost of attaining these objectives. The major logistics functions are warehousing, inventory management and transportation.

Warehousing

Most companies must store their tangible goods while they wait to be sold. To ensure they can meet orders speedily, they must have stock available. A storage function is needed because production and consumption cycles rarely match. For example, a lawnmower manufacturer might produce all year long and store up its products for the heavy spring and summer buying season. The storage function overcomes differences in needed quantities and timing.

A company must decide on *how many* and *what types* of warehouses it needs, and *where* they will be located. The company might use storage warehouses, which store goods for moderate to long periods. Or they may use **distribution centres**, which are designed to move goods rather than just store them. They are large and highly automated warehouses designed to receive goods from various plants and suppliers, take orders, fill them efficiently, and deliver goods to customers as quickly as possible.

Like almost everything else these days, warehousing has seen dramatic changes in technology in recent years. Older, multi-storey warehouses with outdated materials-handling methods are steadily being replaced by newer, single-storey *automated warehouses* with advanced, computer-controlled materials-handling systems requiring few employees. Computers and scanners read orders and direct lift trucks, electric hoists or robots to gather goods, move them to loading docks and issue invoices.

In the European market, more and more producers of industrial and consumer goods are looking to incorporate pan-European distribution networks to provide consistently high standards of service and flexibility. For example, in the face of stiff competition in mainland European markets, British steel producer Corus set up regional distribution centres from which to serve customers across Europe. At the same time, it implemented new IT systems that linked production plants, distribution operators and customers, thus improving service efficiency.¹⁹

Inventory management

Inventory levels also affect customer satisfaction. The major problem is to maintain the delicate balance between carrying too much inventory and carrying too little. Carrying too much inventory results in excessive inventory carrying costs and stock obsolescence. With too little stock, the firm risks not having products when customers want to buy. Stock-outs lead to costly emergency shipments or production, customer dissatisfaction or lost sales as unserved customers switch to a competitor. Hence, in managing inventory, firms must balance the costs of carrying larger inventories against resulting sales and profits.

Today, many companies have greatly reduced their inventories and related costs through *just-in-time* (JIT) logistics systems. Through such systems, producers and retailers carry only small inventories of parts or merchandise, often only enough for a few days of operations. New stock arrives at the factory or retail outlet exactly when needed, rather than being stored in inventory until being used. JIT systems require accurate forecasting along with fast,

Distribution centre—A large, highly automated warehouse designed to receive goods from various plants and suppliers, take orders, fill them efficiently, and deliver goods to customers as quickly as possible.

Warehousing: Robocom Systems specialises in providing warehouse management solutions for a variety of commercial applications. SOURCE: Robocom Systems International (www.robocom.com).



frequent and flexible delivery, so that new supplies will be available when needed. However, these systems result in substantial savings in inventory carrying and handling costs.

Transportation

The choice of transportation carriers affects the pricing of products, delivery performance and condition of the goods when they arrive – all of which will affect customer satisfaction. In shipping goods to its warehouses, dealers and customers, the company can choose among five transportation modes: road, rail, water, pipeline and air. For digital products, firms can use an alternative distribution mode – the Internet.

Road

Trucks are highly flexible in their routing and time schedules. They are efficient for short hauls of high-value merchandise. In the EU, the bulk of goods traded is moved by road vehicles. According to the Conference of European Transport Ministers (CEMT), transport volumes in the EU have risen by more than 50 per cent in the last 20 years.²⁰ The gradual deregulation and removal of restrictive practices in the road transport market in the EU has led to an increase in intra-EU haulage competition, with a downward pressure on rates. Also, there is increasingly greater freedom for international hauliers to transport goods between destinations within one country, resulting in greater efficiency in the use of trucks.

Rail

Railroads are one of the most cost-effective modes for shipping large amounts of bulk products – coal, sand, minerals, farm and forest products – over long distances. The EU's efforts to speed up the development of rail freight and combined road/rail transport services throughout Europe – including the opening up of networks in eastern Europe – are pushing

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rail transport much more firmly into the general distribution spotlight. However, collaboration and standardisation among Europe's railways is necessary to reinforce rail's presence on main cross-border routes.²¹

Water

In countries favourably served by coastal and inland waterways, a large amount of goods can be moved by ships and barges. Although the cost of water transportation is very low for shipping bulky, low-value, non-perishable products such as sand, coal, grain, oil and metallic ores, water transportation is the slowest mode and is affected by the weather. In the EU, waterways' share of freight transport volume is low compared to rail and roads. Its full potential, however, can only be realised through harmonisation of European shipping and port policies and pricing systems, and continued attempts to remove restrictive and unhelpful legislation.

Pipeline

Pipelines are a specialised means of shipping raw commodities such as petroleum, natural gas and chemicals from sources to markets. Most pipelines are used by their owners to ship their own products.

Air

Although the use of air carriers tends to be restricted to low-bulk goods, they are becoming more important as a transportation mode. Air-freight rates are much higher than rail or truck rates, but air freight is ideal when speed is needed or distant markets have to be reached. Among the most frequently air-freighted products are perishables (fresh fish, cut flowers) and high-value, low-bulk items (technical instruments, jewellery). Air freight is advantageous as it reduces inventory levels, packaging costs and the number of warehouses needed.

Internet

The *Internet* carries digital products from producer to customer via satellite, cable modem or telephone wire. Software firms, the media, music companies and education all make use of the Internet to transport digital products. While these firms primarily use traditional transportation to distribute CDs, newspapers and more, the Internet holds the potential for lower product distribution costs.

In choosing a transportation mode for a product, shippers must balance many considerations: speed, dependability, availability, cost, capability and others. Thus, if a shipper needs speed, air and truck are the prime choices. If the goal is low cost, then water or pipeline might be best. In practice, firms may rely on a combination of transportation methods which would best enable them to meet logistics objectives cost-effectively.

Logistics information management

Companies manage their supply chains through information. Channel partners often link up to share information and to make better joint logistics decisions. From a logistics perspective, information flows such as customer orders, billing, inventory levels and even customer data are closely linked to channel performance. Information can be shared and managed in many ways – by mail or telephone, through salespeople, via the Internet, or through *electronic data interchange (EDI)*, the computerised exchange of data between organisations. Retailers such as Tesco and Wal-Mart, for example, maintain EDI links with their major suppliers.²² Benetton, the Italian company, gained a competitive advantage in the past through its management of total supply or throughput time. It uses direct feedback from its franchised outlets to monitor sales trends, links this information into its computer-aided design and manufacturing system and, making use of its highly flexible manufacturing processes,

quickly produces (even small quantities) to order.²³ These companies aim to design simple, accessible, fast and accurate processes for capturing, processing and sharing channel information.

In some cases, suppliers might actually be asked to generate orders and arrange deliveries for their customers. Large retailers are having to work closely with major suppliers to set up *vendor-managed inventory (VMI)* systems or *continuous inventory replenishment* systems.²⁴ Using VMI, the customer shares real-time data on sales and current inventory levels with the supplier. The supplier then takes full responsibility for managing inventories and deliveries. Some retailers even go so far as to shift inventory and delivery costs to the supplier. To work, however, such systems require close cooperation between the buyer and seller.²⁵

Integrated logistics management

Today, companies are increasingly adopting the concept of **integrated logistics management**. This concept recognises that providing better customer service and trimming distribution costs require *teamwork*, both inside the company and among all the marketing channel organisations. Inside the company, the various functional departments must work closely together to maximise the company's own logistics performance. Outside, the company must integrate its logistics system with those of its suppliers and customers to maximise the performance of the entire distribution system.

Cross-functional teamwork inside the company

In most companies, responsibility for various logistics activities is assigned to many different functional units – marketing, sales, finance, manufacturing, purchasing. Too often, each function tries to optimise its own logistics performance without regard for the activities of the other functions. However, transportation, inventory, warehousing and order-processing activities interact, often in an inverse way. For example, lower inventory levels reduce inventory carrying costs. But they may also reduce customer service and increase costs from stock-outs, backorders, special production runs and costly fast-freight shipments. Because distribution activities involve strong trade-offs, decisions by different functions must be coordinated to achieve superior overall logistics performance.

Thus the goal of integrated logistics management is to harmonise all of the company's distribution decisions. Close working relationships among functions can be achieved in several ways. Some companies have created permanent logistics committees made up of managers responsible for different physical distribution activities and for setting policies for improving overall logistics performance.

Companies can also create management positions that link the logistics activities of functional areas. Many companies have created 'supply managers', who manage all of the supply chain activities for each of their product categories. Some have a senior executive for logistics with cross-functional authority.²⁶ Finally, companies can employ sophisticated, system-wide supply chain management software, now available from Oracle, Eqos, Ariba and other software providers.²⁷ The important thing is that the company coordinates its logistics and marketing activities to create high market satisfaction at a reasonable cost.

Building logistics partnerships

Companies must do more than improve their own logistics. They must also work with other channel members to improve whole-channel distribution. The members of a distribution channel are linked closely in delivering customer satisfaction and value. One company's distribution system is another company's supply system. The success of each channel member depends on the performance of the entire supply chain. For example, a big supermarket like

Integrated logistics management—A physical distribution concept that recognises the need for a firm to integrate its logistics system with those of its suppliers and customers. The aim is to maximise the performance of the entire distribution system.

Chapter 20 Managing marketing channels

Asda (owned by Wal-Mart) can charge the lowest prices at retail only if its entire supply chain – consisting of thousands of merchandise suppliers, transport companies, warehouses and service providers – operates at maximum efficiency.

Today, smart companies coordinate their logistics strategies and build strong partnerships with suppliers and customers to improve customer service and reduce channel costs. Many companies have created *cross-functional, cross-company teams*. Other companies partner through *shared projects*. For example, some of the larger retailers – such as Selfridges and House of Fraser – are working with suppliers on in-store programmes. Retailers can allow key suppliers to use their stores as a testing ground for new merchandising programmes. The suppliers spend time at the test stores watching how their product sells and how customers relate to it. They then create programmes specially tailored to the retail outlet and its customers.

Today, more and more companies are also beginning to exploit information technology and the Internet to develop sophisticated electronic, business-to-business (B2B) marketplaces, where companies can build collaborative global procurement, trading or supply chain networks. One example is Covisint, the automotive industry B2B exchange and Web portal launched by General Motors, Daimler-Chrysler and Ford in late 2000, which claimed around 135,000 users across 96 countries by 2004. In February 2004 the privately held portal was acquired by Compuware Corporation, which plans to expand the Web portal used by the automotive industry to other industries, including healthcare and financial services. Other examples of B2B exchanges include ChemConnect in the chemicals and plastics industry, GlobalNetXchange in retailing and MyAircraft.com in the aerospace industry.²⁸

Today, as a result of logistics partnerships, many companies have switched from *anticipatory-based distribution systems* to *response-based distribution systems*.²⁹ In anticipatory distribution, the company produces the amount of goods called for by a sales forecast, holding stocks at various supply points such as the plant, distribution centres and retail outlets, and reordering automatically when its order point is reached. A response-based distribution system, in contrast, is *customer-triggered*. The producer continuously builds and replaces stock as orders arrive. It produces what is currently selling.

For example, in the global motor car industry, manufacturers are coming under increasing pressure to increase the speed of customer response, while also tailoring products to consumer needs, in order to strengthen customer loyalty. Toyota, Ford and GM are all trying out the concept of BTO (build-to-order) or OTD (order-to-delivery). BTO is a system pioneered by Dell. When a customer goes online or calls a freephone number to order his personal computer, Dell assembles the tailored product and ships it to the customer within days. A car is far more complex than a PC, but many car manufacturers believe that they can reduce order-to-delivery time to less than two weeks compared to the three or more months that purchasers currently have to wait. Essentially, a customer will pick her preferred package and, within seconds, the transaction reaches a central database which checks that the order meets an approved design; the car is then scheduled for assembly, based on the earliest date the parts can be shipped. The system should reduce the transaction cost, while taking costs out of the inventory process. The 'dream' is for customers to get all but the most unusual packages within a matter of days!³⁰ ”

Third-party logistics (3PL) provider—An independent logistics provider that performs any or all of the functions required to get its client's product to market.

Companies can outsource many of their complex logistics processes to specialists like DHL who deliver one-stop logistic services ranging from transportation and warehousing to IT-based solutions and logistics financing and consulting.

SOURCE: DHL Worldwide Network/Jung von Matt/Spree.

Third-party logistics

Most businesses perform their own logistics function, but a growing number of firms outsource some or all of their logistics to **third-party logistics (3PL) providers** such as UPS Worldwide Logistics, DHL, FedEx Logistics and Emory Global Logistics. Such integrated logistics companies perform any or all of the functions required to get their clients' product to market. Advance computers and communications make it possible for companies to outsource much more than the simple delivery of physical goods, creating a wide range of



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services including inventory holding and after-sales services. Supply chain outsourcing is evolving from delivery of simple third-party logistics (3PL) through provision of management services (4PL) into full-blown, totally integrated logistics provision (ILP).

For example, DHL and UPS provide clients with coordinated, single-source logistics services including supply chain management, customised information technology, inventory control, warehousing, transportation management, customer service and fulfilment, and freight auditing and control.³¹

Companies outsource supply chain functions for several reasons. First, because getting the product to market is their main focus, these providers can often do it more efficiently and at lower cost. According to one study, outsourcing typically results in 15–30 per cent cost savings. Second, outsourcing logistics frees a company to focus more intensely on its core business.³² Finally, integrated logistics companies understand increasingly complex logistics environments. This can be especially helpful to companies attempting to expand their global market coverage. For example, companies distributing their products across Europe face a bewildering array of environmental restrictions that affect logistics, including packaging standards, truck size and weight limits, and noise and emission pollution controls. By outsourcing its logistics, a company can gain a complete pan-European distribution system without incurring the costs, delays and risks associated with setting up its own system.

Channel trends

We have examined the major channel and logistics decisions facing managers. Finally, let us look at the major changes occurring in distribution channels.

Retailing and wholesaling trends

Retailing trends

Retailers operate in a harsh and fast-changing environment, which offers threats as well as opportunities. For example, in many countries, the industry suffers from chronic overcapacity, resulting in fierce competition for customers. Consumer demographics, lifestyles and shopping patterns are changing rapidly, as are retailing technologies. To be successful, then, retailers will have to choose target segments carefully and position themselves strongly. They will have to take the following retailing developments into account as they plan and execute their competitive strategies.

New retail forms and shortening retail life-cycles

New retail forms continue to emerge to meet new situations and consumer needs, but the life-cycle of new retail forms is getting shorter.³³ Department stores took about 100 years to reach the mature stage of the life-cycle; more recent forms, such as warehouse stores, reached maturity in about 10 years. In such an environment, seemingly solid retail positions can crumble quickly.

Many retailing innovations are partially explained by the **wheel of retailing** concept. According to this concept, many new types of retailing forms begin as low-margin, low-price, low-status operations. They challenge established retailers that have become ‘fat’ by letting their costs and margins increase. The new retailers’ success leads them to upgrade their facilities, carry higher-quality merchandise and offer more services. In turn, their costs increase, forcing them to increase their prices. Eventually, the new retailers become like the conventional retailers they replaced. The cycle begins again when still newer types of retailer

Wheel of retailing—

A concept of retailing which states that new types of retailer usually begin as low-margin, low-price, low-status operations, but later evolve into higher-priced, higher-service operations, eventually becoming like the conventional retailers they replaced.

evolve with lower costs and prices. The wheel of retailing concept seems to explain the initial success and later troubles of department stores, supermarkets and discount stores, and the recent success of off-price and no-frills retailers.³⁴ Thus retailers cannot sit back with a successful formula. To thrive, they must keep adapting and reshaping their business accordingly.

While the wheel of retailing explains the evolution and development of new types of retail store, the concept of the **retailing accordion** can be used to explain the intermittent changes in the depth of retailers' merchandise or the breadth of their operations. Typically, retailers begin by selling a wide assortment of products. They are followed by retailers offering a narrower or more specialised range of products, which in turn are eventually superseded by broad-line mass merchandisers. The theory suggests that retailers pass through a *general-specific-general cycle*. It adequately tapped the evolution of the American retail scene, where the nineteenth-century general stores gave way to the twentieth-century specialist retailers, which were then superseded by the postwar mass merchandisers. The accordion concept may be used to describe the more recent *specific-general-specific cycle* of retailing observed in some sectors.

Retailing accordion—

A phenomenon describing how the width of retailers' product assortment or operations shifts over time: there tends to be a general-specific-general cycle. However, it is possible that many retailing businesses evolve along a specific-general-specific cycle.

For instance, some retailers begin by selling a narrow range or special type of goods, as in a grocery store that carries mainly food, drinks and convenience items. As sales expand, the store manager tends to add new merchandise, such as household goods, stationery, cosmetics and non-prescription drugs, to his or her portfolio. As it grows further, extra services and amenities – for example, delicatessen, fresh-fish-and-seafood counter, in-store bakery, credit card and cheque facilities – are added. This is the path reflected by large supermarkets, which started as narrow-line grocery retailers, stretching out over the years into broad-line superstores. More recently, further growth in edge-of-town superstores is slowing down and out-of-town shopping centres are reaching saturation point. Some of the larger supermarkets are moving back into the high streets. In the UK, Sainsbury's and Tesco reintroduced small town-centre formats, Metro and Central respectively, which are able to trade more profitably now than they could 10 years ago through the supermarkets' increased buying power and efficiency.³⁵

Growth of non-store retailing

Although most retailing still takes place the old-fashioned way across countertops in stores, consumers now have an array of alternatives, including mail order, television, phone and online shopping. Although such advances may threaten some traditional retailers, they offer exciting opportunities for others. Most store retailers are now actively exploring direct retailing channels. In fact, more online retailing is conducted by 'click-and-brick' retailers than by 'click-only' retailers. For example, office-supply retailer Office Depot is now the world's biggest online retailer after Amazon.com.³⁶

Retail convergence

Today's retailers are increasingly selling the same products at the same prices to the same consumers in competition with a wider variety of other retailers. For example, any consumer can buy CDs at about the same price from any or all of a dozen different types of retailers – speciality music stores, discount music stores, electronics superstores, general merchandise

discount stores, video-hire outlets and any of dozens of websites. And when it comes to brand-name appliances, department stores, discount stores, off-price retailers, electronics superstores and a slew of websites all compete for the same customers.

This merging of consumers, products, prices and retailers is called *retail convergence*.³⁷ It is the coming together of shoppers, goods and prices. Customers of all income levels are shopping at the same stores, often for the same goods. Old distinctions such as discount store, speciality store and department store are losing significance: the successful store must match a host of rivals on selection, service and price.

Such convergence means greater competition for retailers and greater difficulty in differentiating offerings. The competition between chain superstores and smaller, independently owned stores has become particularly heated. Because of their bulk buying power and high sales volume, chains can buy at lower costs and thrive on smaller margins. The arrival of a superstore can quickly force nearby independents out of business. For example, Wal-Mart in the UK and Germany has been accused of destroying smaller independents in neighbouring towns.

Yet the news is not all bad for smaller companies. Many small, independent retailers are thriving. They are finding that sheer size and marketing muscle are often no match for the personal touch that small stores can provide or the speciality niches that small stores fill for a devoted customer base.

The rise of mega-retailers

The rise of huge mass merchandisers and speciality superstores, the formation of vertical marketing systems and buying alliances, and a rash of retail mergers and acquisitions have created a core of superpower mega-retailers. In the grocery sector, for example, the battle for global power among the 80 large supermarket groups in Europe has created a superleague of fewer than 10 heavyweight retailers including Wal-Mart, Carrefour, Metroag, Tesco, Ahold, Groupe Casino, Sainsbury's and Delhaize.

Through their superior information systems and buying power, these giant retailers are able to offer better merchandise selections, good service and strong price savings to consumers. As a result, they grow even larger by squeezing out their smaller, weaker competitors. The mega-retailers also are shifting the balance of power between retailers and producers. A relative handful of retailers now control access to enormous numbers of consumers, giving them the upper hand in their dealings with manufacturers.

The growing importance of retail technology

Retail technologies are becoming critically important as competitive tools. Progressive retailers are using computers to produce better forecasts, control inventory costs, order electronically from suppliers, send email between stores, and even sell to customers within stores. They are adopting checkout scanning systems, online transaction processing, electronic funds transfer, electronic data interchange, in-store television and improved merchandise-handling systems.

Perhaps the most startling advances in retailing technology concern the ways in which today's retailers are connecting with customers. In the past, retailers connected with their customers through stores, through their salespeople, through the brands and packages they sold, and through direct mail and advertising in the mass media. But today, life is more complex. There are dozens of new ways to attract and engage consumers. Indeed, even if one omits the obvious – the Web – retailers are still surrounded by technical innovations that promise to redefine the way they and manufacturers interact with customers. Consider touch-screen kiosks, electronic shelf labels and signs, handheld shopping assistants, smart cards, self-scanning systems, virtual reality displays and intelligent agents. So, if we ask the question, 'Will technology change the way retailers interface with customers in the future?', the answer has got to be yes.³⁸

Global expansion of retailers

Retailers with unique formats and strong brand positioning are increasingly moving into other countries. Many are expanding internationally to escape mature and saturated home markets. Over the years, several giant US retailers – McDonald's, KFC, Gap, Toys 'R' Us, Wal-Mart – have become prominent in countries around the world as a result of their great marketing prowess. However, European and Asian retailers are ahead of the US when it comes to global expansion. Only 18 per cent of the top US retailers operate globally, compared to 40 per cent of European retailers and 31 per cent of Asian retailers. Among the European retailers that have gone global are Britain's Tesco and Marks & Spencer, Italy's Benetton, France's Carrefour hypermarkets and Sweden's Hennes & Mauritz and IKEA home furnishing stores.³⁹

Marks & Spencer, which started out as a penny bazaar in 1884, grew into a chain of variety stores over the decades and now has a thriving string of over 150 franchised stores around the world, which sell mainly its private-label clothes, including Brooks Brothers. It also runs a major food business. IKEA's well-constructed but fairly inexpensive furniture has proven very popular in countries across the world, where shoppers often spend an entire day in an IKEA store. Europe's largest fashion retailer, Hennes & Mauritz, has 945 stores in 18 countries and plans to accelerate the pace of its global expansion with the opening of another 140 new stores over 2004. And French discount retailer Carrefour, the world's second largest retailer after Wal-Mart, has embarked on an aggressive mission to extend its role as a leading international retailer.⁴⁰

Although many retailers appear to have caught globalisation fever, not all have done well. Despite the enthusiasm, retailers have found that store retailing is proving difficult to transfer across national frontiers. UK retailers Dixons, Habitat, Mothercare and Next have been forced to retreat from the US. Even Italy's Benetton, a past master at internationalisation, had to close hundreds of US stores in the early 1990s. And, as Carrefour and Wal-Mart found, entry into foreign markets is not trouble-free (see Marketing Insights 20.2).

Trends in wholesaling

As the wholesaling industry moves into the twenty-first century, it faces considerable challenges. The industry remains vulnerable to one of the most enduring trends of the last decade – fierce resistance to price increases and the winnowing out of suppliers who are not adding value based on cost and quality. Progressive wholesalers constantly watch for better ways to meet the changing needs of their suppliers and target customers. They recognise that, in the long run, their only reason for existence comes from adding value by increasing the efficiency and effectiveness of the entire marketing channel. To achieve this goal, they must constantly improve their services and reduce their costs.

The distinction between large retailers and large wholesalers continues to blur. There are retailers that operate formats such as wholesale clubs and hypermarkets that perform many wholesale functions. In return, many large wholesalers are setting up their own retailing operations. A prime example of this type of *hybrid* operator is the cash-and-carry self-service wholesaler Makro, which in one sense is a limited-service wholesaler, selling primarily to the trade – that is, to small shopkeepers/retailers. In another sense, Makro is also a large retailer in

Retail giants: coming to terms with the global marketplace

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As major store retailers within national boundaries have consolidated into corporate giants and domestic markets have become ever more crowded, the big players have been crossing borders for growth opportunities. However, store retailing is a business that is proving difficult to transfer across national frontiers. Even for those whose international businesses are well advanced, including Carrefour and Wal-Mart, getting things right in international markets is not easy.

First, consider the French retailer Carrefour. Like other foreign retailers, from food to luxury goods, Carrefour was drawn to the ¥143,000 billion (€1,290 billion) Japanese retail market by its consumers' high disposable incomes and declining land prices. Carrefour has 9,600 stores in 30 countries worldwide. Emboldened by its success in other countries, Carrefour entered Japan in 2000 and now operates seven outlets in the world's second largest retail market.

However, from the very beginning, the retail group had misread consumers and alienated wholesalers. Consumers turned away on finding low-priced Japanese fare that jarred with their expectations of French delicacies at lavish prices. It faced hostility from wholesalers with its pricing demands and refusal to accept their multi-layered distribution system, leaving the retailer often struggling to maintain stocks.

Following this troubled entry, Carrefour's superstores now offer French products and cluster food items to suit Japanese tastes. They offer cut-portions of fruit and a wider range of ready-to-eat meals. They now have relations with second-tier suppliers who are often blocked by the cartel-like structure of the Japanese wholesale system. Expansion is also now focused more on western Japan where lower prices are more likely to attract shoppers than in Tokyo. Nonetheless, while the French retail group is looking to recover from its troubled entry into Japan, whatever the future for Carrefour, competitors are already responding to opportunities in this market. Wal-Mart and Tesco have entered Japan and local market-leaders like Aeon are slashing prices and expanding aggressively with new super-store formats. The question is whether Carrefour can do it alone – some of their teething problems could have been avoided had they taken the conventional route and entered through a joint venture partner or acquisition. Being too aggressive and arrogant at the beginning, Carrefour must now accept that some things work better in Japan the Japanese way.

Carrefour is not alone. The problems facing the world's largest retailer, America's Wal-Mart, when it entered the German market are instructive. Through its acquisition of the Wertkauf hypermarket in 1997 and Interspar in 1998, Wal-Mart Germany became the country's fourth largest hypermarket chain. Although this move initially sent shockwaves through the European retail industry, the German venture

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was proving to be performing poorly, losing \$200–300 million (€224–333 million) a year.

Volker Barth, head of Wal-Mart Germany, acknowledges that they did make mistakes. The most serious one was disregarding the German food retailing distribution structure. To control the distribution to stores, the company centralised procurement rather than left it to suppliers. This resulted in delivery chaos and stock-out rates as high as 20 per cent compared with a 7 per cent average for the industry. Although sizeable, with 10 per cent of the hypermarket sector, Wal-Mart Germany had less than 2 per cent of the food retail market. It lacked the purchasing muscle to dictate to suppliers and distributors, unlike Edeka and Rewe with a combined market share of 30 per cent. Moreover, in a sector already dominated by hard discounters, Wal-Mart's 'low-price message' was nothing new. Rivals quickly matched its price cuts. High renovation costs and the complexity of Germany's planning and social regulations have also delayed planned refurbishment of stores, with many remaining unattractive or in the wrong locations. Poor-quality staff and sloppy customer service at its Interspar stores have not helped either.

Wal-Mart also acknowledged misjudging corporate culture. Filling the top positions at the German stores with US expatriates prompted an exodus of German managers, which denied the group local expertise. Wal-Mart's losses in Germany may be reconcilable, given the venture is in its infancy. IKEA waited eight years until its US store eventually went into profit.

For now, both Carrefour and Wal-Mart continue to follow their global expansion paths. But one thing's for certain – to succeed they have to blend their products and services, quality and prices to suit local tastes. And management has to be responsive to new ideas and local systems of doing business. As a spokesperson for an Asian retail conglomerate noted, 'We considered alliances with Wal-Mart and Carrefour but they both had an attitude that their way was best. So we chose Tesco instead because we were impressed by how open its management was to new ideas.'

SOURCES: Bayan Rahman, 'Carrefour begins a new era in Japan', *Financial Times* (6 October 2003), p. 26; Andrew Ward, 'An octopus in the shopping trolley', *Financial Times* (11 January 2002), p. 9; Fraser Nelson, 'Grocers must play their cards right', *The Times* (1 September 1999), p. 9; 'Shopping all over the world', *The Economist* (19 June 1999), pp. 83–9; Bertrand Benoit, 'Wal-Mart finds German failures hard to swallow', *Financial Times* (12 October 2000), p. 25; Peggy Hollinger and Chris Tighe, 'C&A was forced down market and now out', *Financial Times* (16 June 2000), p. 3; Ian Bickerton, 'A victim of fashion', *Financial Times* (27 June 2000), p. 18; Peggy Hollinger, 'A shopping market stacked with difficulties', *Financial Times* (2 August 2000), p. 19.

that many of the 'trade visitors' who purchase goods from its warehouse are not resellers but individuals bulk-buying for personal consumption.⁴¹

Wholesalers will continue to increase the services they provide to retailers – retail pricing, cooperative advertising, marketing and management information reports, accounting services, online transactions and others. Rising costs on the one hand, and the demand for increased

services on the other, will put the squeeze on wholesaler profits. Wholesalers who do not find efficient ways to deliver value to their customers will soon drop by the wayside. However, the increased use of computerised, automated and Web-based systems will help wholesalers to contain the costs of ordering, shipping and inventory holding, boosting their productivity.

Finally, facing slow growth in their domestic markets and the trend towards globalisation, many large wholesalers are going global, thus creating new challenges for the wholesaling industry worldwide. To survive, players must learn to adapt to their changing environment. Like their customers – the resellers or retailers, whose success relies on their ability to capture and retain customers by offering better value than the competition can – wholesalers must consistently add to that value-creation process. For all channel partners, wholesalers and retailers alike, nothing happens until a sale takes place, until customers buy. And there are no long-term rewards unless these customers come back for more!

Summary

Producing a product or service and making it available to buyers requires building relationships not just with customers, but also with key suppliers and resellers in the company's *supply chain*. Marketers have traditionally focused on the distribution or *marketing channels* that look forward towards the customer. A company's channel decisions directly affect every other marketing decision. Each channel system creates a different level of revenues and costs, and reaches a different segment of target customers. Most producers try to forge a *marketing channel* – a set of interdependent organisations involved in the process of making a product or service available for use or consumption by the consumer or business user. Through their contacts, experience, specialisation and scale of operation, intermediaries usually offer the firm more than it can achieve on its own.

Marketing channels perform many key functions: *information gathering and dissemination, communication and promotion, contact work, matching offers to buyers' needs, negotiation, physical distribution, financing, and risk taking.*

The channel is most effective when each member is assigned the tasks it can do best and all members work together smoothly. They should understand and accept their roles, coordinate their goals and activities and cooperate to attain overall channel goals. In recent years, new types of channel organisation have appeared that provide stronger leadership for assigning roles and managing conflict, leading to improved performance.

Each firm needs to identify alternative ways to reach its market. These vary from direct selling to using one, two, three or more intermediary *channel levels*. Marketing channels face continuous change. Three of the most important trends are the growth of *vertical, horizontal and multi-channel or hybrid marketing systems*. These trends affect channel cooperation, conflict and competition.

Channel design begins with assessing customer channel-service needs and company channel objectives and constraints. The company then identifies the main channel alternatives in terms of the *types* of intermediary, the *number* of intermediaries and the *channel responsibilities* of each.

There are many types of channel intermediary, ranging from wholesalers, brokers and agents to retailers. *Wholesaling* includes all the activities involved in selling goods or services to those who are buying for the purpose of resale or for business use. Wholesalers perform many functions, including selling and promoting, buying and assortment building, bulk-breaking, warehousing, transporting, financing, risk bearing, supplying market information and providing management services and advice.

Wholesalers fall into three groups: *merchant wholesalers* take possession of the goods; *agents* and *brokers* do not take possession of the goods but are paid a commission for aiding buying and selling; and *manufacturers' sales branches and offices* are wholesaling operations conducted by non-wholesalers to bypass the wholesalers.

Retailers perform activities involved in selling goods and services directly to final consumers for their personal, non-business use. Retailers can be classified as *store retailers* and *non-store retailers*. They can be further classified by the *amount of service* they provide (e.g. self-service, limited service or full service); *product line sold* (e.g. speciality store, department store, supermarket, convenience store, superstores); and their *relative price emphasis* (e.g. discount store, category killer, off-price retailers). Today, many retailers are banding together in corporate and contractual *retail organisations* (e.g. corporate chains, voluntary chains and retailer cooperatives, franchise organisations and merchandising conglomerates).

Each channel alternative must be evaluated according to economic, control and adaptive criteria. Channel management calls for selecting, motivating and periodically evaluating qualified intermediaries. The company must sell not only *through* the intermediaries, but *to* and *with* them. The key is to forge long-term partnerships with their channel partners to create a marketing system that meets the needs of both the manufacturer and the partners. Companies operating in different geographic markets can apply the key principles of channel management, but must adapt approaches to the conditions in international markets.

More business firms are now paying attention to *physical distribution* or *marketing logistics*. Marketing logistics involves coordinating the activities of the entire *supply chain* – inbound, outbound and reverse distribution – to maximise value to customers. No logistics system can both maximise customer service and minimise distribution costs. The goal of logistics management is to provide a *targeted* level of service at the least cost. The major logistics functions include *warehousing*, *inventory management*, *transportation* and *logistics information management*.

Increasingly, companies adopt the *integrated logistics concept* as they recognise that improved logistics requires teamwork in the form of close working relationships across functional areas inside the company and across various organisations in the supply chain. Companies achieve logistics harmony among functions by creating cross-functional logistics teams, integrative supply manager positions and senior-level logistics executives with cross-functional authority. Channel partnerships can take the form of cross-company teams, shared projects and information-sharing systems. Today, some companies are outsourcing their logistics functions to third-party logistics providers to reduce costs, increase efficiency and gain faster and more effective access to global markets.

Discussing the issues

1. Explain the purpose of a company's supply chain. Is the term 'supply chain' too limited for today's business activities? Using examples, explain what you understand to be a firm's value delivery network and to what extent it is different from a supply chain.
2. What is disintermediation? Give an example other than those discussed in the chapter. What opportunities and problems does disintermediation present for traditional retailers? Explain.
3. In only the past few years, online retailing has boomed.
 - (a) How will retailers going online change the competitive balance between retailers, direct and catalogue marketers, wholesalers and manufacturers?

- (b) What are the major advantages of online retailing? The pitfalls?
- (c) What do you predict will be the future of online retailing?
- 4. List and describe each of the channel functions that have been traditionally assigned to wholesalers.
 - (a) How will wholesalers have to change to meet the threat of increasing competition from large retailers?
 - (b) What type of wholesaler is best equipped to compete and evolve in the next decade? Explain.
- 5. Many European and US retailers are seeking to expand globally.
 - (a) What key factors might govern successful international expansion?
 - (b) Thinking of examples of local retailers, explain which of these might be well positioned for global expansion.
 - (c) How will online retailing affect global retail expansion?
 - (d) Study Sweden's IKEA home furnishing stores (www.ikea.com). Why has IKEA been so successful in expanding into overseas markets?

Applying the concepts

1. You probably have heard of an extranet. An extranet occurs when a company opens part of its own internal network (or intranet) to trusted suppliers, distributors and other selected external business partners. Via such extranets, a company can communicate quickly and efficiently with its partners, complete transactions and share data. A supplier might analyse the customer's inventory needs. Partners might swap customer lists for interrelated products and services or share purchasing systems to gain savings through more efficient purchasing. These 'virtual partners' communicate in nanoseconds about shifting supply and demand situations, customer requests and opportunities, and just-in-time inventory needs. Purchase processing times can be reduced from weeks to minutes at enormous cost savings, which can then be passed along to consumers.
 - (a) What role will extranets play in distribution decisions for retailers, wholesalers and manufacturers?
 - (b) Discuss the potential dangers and benefits of an extranet system.
 - (c) How might outsourcers employ the extranet concept (if at all)? What types of activities and information might be shared on such extranets? What might be their advantages and disadvantages?
2. Virtual retailing is touted to have a bright future, thanks to consumer demand for more and more service and customisation. Through virtual retailing, a seller comes directly into your home, at your convenience, and allows you to design your own personalised product and shopping experience. This sounds great – no high-pressure salespeople and no congested car parks. At a virtual retail site, you can take as much or as little time as you like to make up your own mind. And virtual retailing has made mass customisation a reality. Select a product (e.g. clothing, shoes, spectacles) and identify a company whose website allows you to customise its products. Visit the website of the company you have selected.
 - (a) How does virtual retailing compare with traditional shopping formats? What are the major advantages and disadvantages for consumers?
 - (b) Try to design your own product. Discuss the pros and cons of your experience. How would this experience be different from buying in a retail store? Would you be willing to purchase the item you designed? Why or why not?

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Concluding concepts 20

Pieta luxury chocolates



Peter Abel, the young managing director of his family's firm, was pleased with the way he had revitalised the firm after he took over 10 years ago. Since being formed in 1923, Pieta had sold its luxury Belgian chocolates through its own small shops. It had a high reputation within the trade and many devoted customers. It was the country's largest luxury chocolate manufacturer, but until Peter took over, the company had stagnated. In his opinion, Pieta should be more like other leading family firms such as Cadbury, Ferrero and Mars.

When he took over, he launched the company into new ventures. Franchising widened distribution to some small shops which now had corners devoted to Pieta's range. He felt these did not compete with Pieta's own shops because the franchisees were CTNs (confectioners, tobacconists and newsagents), where people made many impulse purchases. These contrasted with Pieta's shops, which people visited to make purchases for a special occasion or as an indulgence. Other distribution channels that were developed included

own-label to Marks & Spencer in the UK, direct mailing for special occasions, and exporting (see Exhibit 20.1).

There were some new Pieta shops and 20 per cent of the old ones were refurbished. The refurbishment rate was slower than he would have liked, for he knew that

many of the shops were poorly located, cluttered and overcrowded. The well-sited shops often had queues trailing out of their doors when they were busy, but most did not do so well. The company had not kept pace with changes in shopping and geodemographics. Most of Pieta's shops were on secondary sites in declining industrial towns. Other new channel opportunities, such as 'shop-in-shop' outlets and international expansion, had also been largely ignored.

However, the product range was now wider. The chocolate market was seasonal, so the shops sold ice-creams to help summer sales. The outlets also carried a range of greetings cards and Pieta gift vouchers to make them more of a one-stop shop. Soon he would be introducing countlines aimed at the mass market (countlines are wrapped bars, such as KitKat, or small bags of products such as M&Ms).

As a result of his efforts, Peter was able to present a dynamic set of results to his family shareholders (see Exhibit 20.2). He was angry to find that some shareholders were not as supportive as they had been. Some worried about the company's reputation being spoilt by it becoming less exclusive. Others were anxious about the new injection of equity he was requesting. He thought it odd that the strategy they had supported and backed financially two years ago was now in question. He reminded them how well the firm had done despite the tough economic climate over the last few years (see Exhibit 20.3). The

Pieta had been Belgium's largest luxury chocolate manufacturer, but the company had stagnated.

Exhibit 20.1 Channel performance

Year	Sales tonnage					Number of own shops
	Own shops	CTN franchise	M&S own label	Direct mail	Export	
1994	6,049	1	3	3	3	128
1995	7,203	92	255	136	11	130
1996	8,351	392	661	167	24	130
1997	9,933	1,002	636	172	149	132
1998	11,845	1,303	462	205	184	138
1999	14,753	1,259	868	205	167	148
Gross margin (%)	55	45	37	35	33	
Net profit (%)	6	14	7	3	[6]	

Chapter 20 Managing marketing channels

Exhibit 20.2 Company performance (Bfr m)

Year	Sales	Gross profit	Net profit	Net assets	Equity	Debt
1989	2,262	1,285	282	1,218	809	409
1990	2,222	1,215	308	1,305	885	420
1991	2,783	1,568	387	1,503	1,043	460
1992	3,461	1,961	636	1,896	1,241	655
1993	4,270	2,405	723	2,373	1,488	885
1994	5,653	3,005	779	2,931	1,735	1,196
1995	7,091	4,066	951	3,425	2,002	1,423
1996	8,821	4,696	793	4,228	2,217	2,011
1997	10,887	5,803	975	4,749	2,661	2,088
1998	12,826	6,891	1,123	6,201	2,594	3,607
1999	15,551	9,064	1,372	7,515	3,113	4,402

Exhibit 20.3 Economic performance

Year	Retail Price Index	CTN Price Index	Cost of Living Index	Cost of debt (%)	Cost of equity (%)
1989	100	100	100	11	13
1990	108	107	109	9	12
1991	133	121	117	11	17
1992	151	131	128	14	18
1993	175	155	148	16	23
1994	208	191	184	17	28
1995	238	223	213	17	21
1996	271	257	251	12	20
1997	310	285	274	13	26
1998	345	297	311	16	23
1999	389	351	360	16	25

company was now more professional than it had ever been. He had just introduced a new tier of senior people to manage the day-to-day operations of the company. These were not family members, but were bright and very well qualified and had broad experience within the industry. With them in place he would have more time to think about and initiate other ways of developing the company.

Questions

1. Comment on Abel's expansion strategy and Pieta's performance since he took over.
2. Argue the case for further expansion wanted by Abel.
3. What is the scope for channel innovation in the industry?
4. How is Abel's strategy endangering Pieta's future performance and brand image? What, if anything, has Abel been neglecting?
5. Track the changes in C³ (capital cost covered) and EVA (economic value added) for Pieta over the last ten years. Marketing Insights 16.1 shows how to do this.
6. Comment on the C³ and EVA trends and compare them with the impression given by the growth in profits and sales. What strategies of Abel's explain the performance that the C³ and EVA reveal? Should the trend be changed and, if so, how could it be changed?

SOURCE: From company records. All dates, figures and names have been changed for commercial reasons.