CHAPTER 15

Designing and Managing Distribution Channels

Asian Paints has expanded beyond its famed retail outlets with tinting machines for custom shades of paints to sell online with easy tools for product selection that match the home's decor.
Source: ©Asian Paints Ltd, used with permission

Learning Objectives After studying this chapter you should be able to:

15.1 Define the roles of marketing channels.
15.2 Explain the key channel-management decisions.
15.3 Discuss how firms manage channel cooperation and conflict.
15.4 Discuss how firms manage market logistics.

Asian Paints, founded in 1942, is one of the world's biggest paint companies known for its wide range of products and extensive distribution channel. In its legacy of eight decades, the company has maintained the leader's position since 1967, offering painting, home improvement and décor solutions. It follows a multi-channel distribution system, driven by strong customer focus and the spirit of innovation. Its integrated distribution system plays a significant role in effectively managing its worldwide customer base spread in 60 countries. The group operates offline as well as online distribution channels, with a very strong focus on its retail outlets. Asian Paints' multiple offerings and store formats, including Signature stores, ColourIdeas and AP Beautiful Homes serve different customer segments. The key factor responsible for its successful and effective supply chain management is the company's ability to offer quick solutions to cope with a varied range of demand through its robust network of over 50,000 dealers. These dealers are equipped with tinting machines to enable them to quickly offer any shade of colour demanded. Mixing and matching the colours within dealer's premises, create a significant point of differentiation by reducing the lead time for any colour sought by its customers. With a share of more than 50%, the market leader generated revenues of over ₹20,000 crore for 2020–21.[1]

Successful value creation needs successful value delivery. Instead of limiting their focus to their immediate suppliers, distributors, and customers, holistic marketers are examining the whole supply chain as a value network, including their suppliers' suppliers upstream and their distributors' customers downstream. They are also looking at how technology is changing the way customers shop and retailers sell and finding new and different means to distribute and service their offerings. Consider how Asian Paints develops strong customer ties with a well-executed channel strategy.

With the advent of e-commerce (selling online) and m-commerce (selling via mobile devices), customers are buying in ways they never have before. Companies today must build and manage a continuously evolving and increasingly complex channel system and value network. In this chapter, we consider strategic and tactical issues in integrating marketing channels and developing value networks. We will examine marketing channel issues from the perspective of retailers in Chapter 17.

THE ROLE OF DISTRIBUTION CHANNELS

Most producers do not sell their goods directly to the final users; between them stand a set of intermediaries performing a variety of functions. These intermediaries constitute a marketing channel (also called a trade channel or distribution channel). **Distribution channels** are sets of interdependent organizations participating in the process of making a product or service available for use or consumption. They are the set of pathways a product or service follows after production, culminating in purchase and consumption by the final end user.[2]

Some intermediaries—such as wholesalers and retailers—buy, take title to, and resell the merchandise; these intermediaries are called **merchants**. Others—brokers, manufacturers' representatives, sales agents—search for customers and may negotiate on the producer's behalf but do not take title to the goods; they are called **agents**. Still others—transportation companies, independent warehouses, banks, advertising agencies—assist in the distribution process but neither take title to goods nor negotiate purchases or sales; they are called **facilitators**.

Channels of all types play an important role in the success of a company and affect all other marketing decisions. Marketers should judge them in the context of the entire process by which their products are made, distributed, sold, and serviced. One of the chief roles of marketing channels is to convert potential buyers into profitable customers. Marketing channels must not just *serve* markets, they must also *make* them.

The channels chosen affect all other marketing decisions. The company's pricing depends on whether it uses online discounters or high-quality boutiques. Its sales force and advertising decisions depend on how much training and motivation dealers need. In addition, channel decisions include relatively long-term commitments with other firms, as well as a set of policies and procedures. When an automaker signs up independent dealers to sell its automobiles, it cannot buy them out the next day and replace them with company-owned outlets. But at the same time, channel choices themselves depend on the company's marketing strategy. Holistic marketers ensure that marketing decisions in all these different areas are made to maximize value overall.

Why does a producer delegate some of the selling job to intermediaries, relinquishing control over how and to whom its products are sold? Through their contacts, experience, specialization, and scale of operation, intermediaries make goods widely available and accessible to target markets, offering more effectiveness and efficiency than the producing firm could achieve on its own.

Many producers lack the financial resources and expertise to sell directly to their customers. The William Wrigley Jr. Company would not find it practical to establish small retail gum shops throughout the world or to sell gum online or by mail order. It is easier to work through the extensive network of privately owned distribution organizations. Even Ford would be hard pressed to replace all the tasks done by its 8,000+ dealer outlets worldwide.

DISTRIBUTION CHANNEL FUNCTIONS

A distribution channel performs the work of moving goods from producers to consumers. It overcomes the time and place gaps that separate goods and services from those who need or want them. Members of the marketing channel perform a number of key functions:

- Gather information about potential and current customers, competitors, and other actors and forces in the marketing environment.
- Develop and disseminate persuasive communications to stimulate purchasing and foster brand loyalty.
- Negotiate and reach agreements on price and other terms so that transfer of ownership or possession can be effected.
- Place orders with manufacturers.
- Acquire the funds to finance inventories at different levels in the marketing channel.
- Assume risks connected with carrying out channel work.
- Provide buyers with financing and facilitate payment.
- Provide for buyers' payment of their bills through banks and other financial institutions.
- Oversee actual transfer of ownership of goods from one organization or person to another.

All channel functions have three characteristics in common: They use up scarce resources, they can often be performed better through specialization, and they can be shifted among channel members. Channel functions can be illustrated in terms of flows of goods and services across distribution channels. Five of the most common flows are illustrated in Figure 15.1. If these flows were superimposed in one diagram, we would see the tremendous complexity of even simple marketing channels.

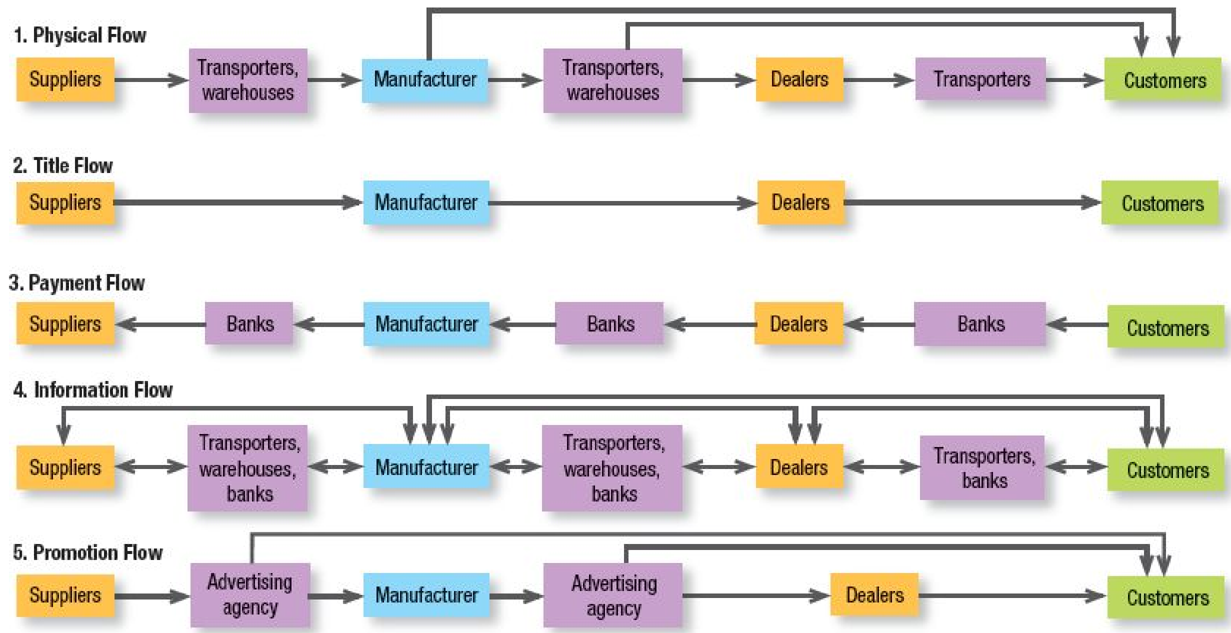

FIGURE 15.1
Five Marketing Flows in the Marketing Channel

Many of the channel functions involve bi-directional flows of goods and services. Some of these functions (storage and movement, title, and communications) constitute a *forward flow* of activity from the company to the customer; others (ordering and payment) constitute a *backward flow* from customers to the company. Still others (information, negotiation, finance, and risk taking) occur in both directions.

The question for marketers is not *whether* various channel functions need to be performed—they must be—but, rather, *who* is to perform them. Shifting some functions to intermediaries lowers the producer's costs and prices, but the intermediary must add a charge to cover its work. If the intermediaries are more efficient than the manufacturer, prices to consumers should be lower. If consumers perform some functions themselves, they should enjoy even lower prices. Changes in channel institutions thus largely reflect the discovery of more efficient ways to combine or separate the economic functions that provide assortments of goods to target customers.

CHANNEL LEVELS

Distribution channels can be described by the number of intermediaries that exist between the producer and the final customer. The number of intermediaries, also referred to as channel levels, define the length and breadth of the distribution channel. Figure 15.2(a) illustrates several consumer-goods marketing channels of different lengths.

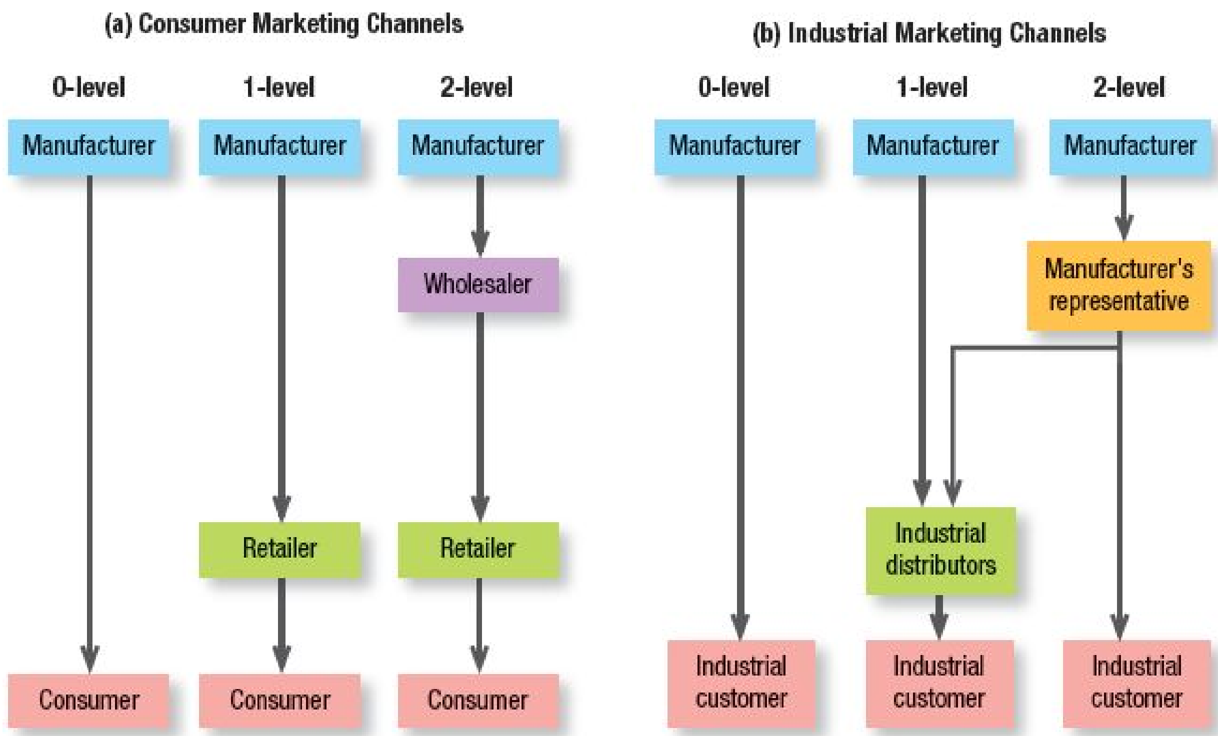

FIGURE 15.2
Consumer and Industrial Marketing Channels

A **zero-level channel**, also called a **direct marketing channel**, consists of a manufacturer selling directly to the final customer. The major examples are mail order, online selling, TV selling, telemarketing, door-to-door sales, home parties, and manufacturer-owned stores. Traditionally, Franklin Mint sold collectibles through mail order; Red Envelope sold gifts online; Time-Life sold music and video collections through TV commercials or longer infomercials; nonprofits and political organizations and candidates used the telephone to raise funds; Avon sales representatives sold cosmetics door to door; Tupperware sold its containers via in-home parties; and Apple sold computers and other consumer electronics through its own stores. Many of these firms now sell directly to customers online and via catalogs. Even traditional consumer-product firms are considering adding direct-to-consumer e-commerce sites to their channel mix. Kimberly-Clark has launched an online Kleenex Shop in the United Kingdom.

A **single-level channel** contains one selling intermediary, such as a retailer. A **dual-level channel** contains two intermediaries, typically a wholesaler and a retailer. In Japan, where density of the urban population is high and retail outlets are fragmented, food distribution may include as many as six levels! Obtaining information about end users and exercising control become more difficult for the producer as the number of channel levels increases.

Figure 15.2(b) shows channels commonly used in B2B marketing. An industrial-goods manufacturer can use its sales force to sell directly to industrial customers, or it can sell to industrial distributors who sell to industrial customers, or it can sell through manufacturers' representatives or its own sales branches directly to industrial customers or indirectly to industrial customers through industrial distributors. Zero-, one-, and two-level marketing channels are quite common.

Channels normally describe a forward movement of products from source to user, but **reverse-flow channels** are also important. Reverse-flow channels perform several important functions, such as to reuse products or containers (such as refillable chemical-carrying drums), refurbish products for resale (such as circuit boards or computers), recycle products, and dispose of products and packaging. Reverse-flow intermediaries include manufacturers' redemption centers, community groups, trash-collection specialists, recycling centers, trash-recycling brokers, and central processing warehousing.

MULTICHANNEL DISTRIBUTION

Today's successful companies typically employ multichannel distribution, using two or more marketing channels to reach customer segments in one market area. HP uses its sales force to sell to large accounts, outbound telemarketing to sell to medium-sized accounts, direct mail with an inbound phone number to sell to small accounts, retailers to sell to still smaller accounts, and the internet to sell specialty items. Each channel can target a different segment of buyers, or different need states for one buyer, to deliver the right products in the right places in the right way at the least cost.[3]

When different channels target the same customers, channel conflict, excessive cost, or insufficient demand can result. Dial-a-Mattress successfully grew for three decades by selling mattresses directly over the phone and later online. A major expansion into 50 brick-and-mortar stores in major metro areas was a failure, however. Secondary locations, chosen because management considered prime locations too expensive, could not generate enough customer traffic. The company eventually declared bankruptcy.[4]

On the other hand, when a major catalog and internet retailer invested significantly in brick-and-mortar stores, different results emerged. Customers near the store purchased through the catalog less frequently, but their online purchases were unchanged. As it turned out, customers who liked to spend time browsing were happy to either use a catalog or visit the store; those channels were interchangeable. Customers who shopped online, on the other hand, were more transaction focused and interested in efficiency, so they were less affected by the introduction of stores. Returns and exchanges at the stores were found to increase because of ease and accessibility, but extra purchases made by customers returning or exchanging at the store offset any revenue deficit.[5]

Research has shown that multichannel customers can be more valuable to marketers.[6] Nordstrom found that its multichannel customers spend four times as much as those who shop only through one channel, though some academic research suggests that this effect is stronger for hedonic products (apparel and cosmetics) than for functional products (office and garden supplies).[7]

Most companies today have adopted multichannel marketing. Disney sells its videos through multiple channels: movie rental merchants such as Netflix and Redbox, Disney Stores (owned and run by The Children's Place), retail stores such as Best Buy, online retailers such as Disney's own online stores and Amazon.com, the Disney Club catalog and other catalog sellers, as well as its subscription streaming service Disney+. This variety affords Disney maximum market coverage and enables it to offer its videos at a number of price points.

Sometimes a company chooses a new or unconventional channel because of the difficulty, cost, or ineffectiveness of working with the dominant channel. When video rental stores were rapidly declining, Coinstar successfully introduced the Redbox chain of conveniently located DVD- and game-rental kiosks. Netflix quickly moved away from the revolutionary channel that brought it much success—direct mail—to capitalize on a new one.

Companies are increasingly employing digital distribution strategies, selling directly online to customers or through e-merchants who have their own websites. In doing so, these companies are seeking to ensure that different channels work seamlessly together and match each target customer's preferred ways of doing business, delivering the right product information and customer service regardless of whether customers are online, in the store, or on the phone.

Using multiple distribution channels gives companies three important benefits. The first is increased market coverage. Not only are more customers able to shop for the company's products in more places, as noted previously, but those who buy in more than one channel are often more profitable than single-channel customers.[8] The second benefit is lower channel cost. Selling online or by catalog and phone is cheaper than using personal selling to reach small customers. The third is the ability to do more customized selling—such as by adding a technical sales force to sell complex equipment.

Using a single channel is typically not very efficient. Consider a direct sales force. A salesperson would have to find leads, qualify them, presell, close the sale, provide service, and manage account growth. With an integrated multichannel approach, however, the company's marketing department could run a preselling campaign informing prospects about the company's products through advertising, direct mail, and e-mails; generate leads through telemarketing, more e-mails, and trade shows; and qualify leads as hot, warm, or cool. The salesperson enters when the prospect is ready to talk business and invests his or her costly time primarily in closing the sale. This multichannel architecture optimizes coverage, customization, and control while minimizing cost and conflict.

There is a trade-off, however. New channels typically introduce conflict and problems with control and cooperation. Two or more may end up competing for the same customers.[9] Clearly, companies need to think through their channel architecture and determine which channels should perform which functions.[10]

Managing the online and offline channels has thus become a priority for many firms.[11] There are at least three strategies for trying to gain acceptance from intermediaries. One option involves offering different brands or products online and offline. The second option entails offering offline partners higher commissions to cushion the negative impact on sales. The third option involves taking orders on the website but having retailers deliver and collect payment. Mercedes-Benz decided to tread carefully before going online.

> **Mercedes-Benz** Mercedes-Benz launched its new distribution model, 'Retail of the future' (ROTF) in India in June 2021. Launching a direct distribution channel is a path-breaking move in the luxury car retail segment. Mercedes-Benz started using digital channels to sell its products with the help of new channel partners called 'franchise Partners'. With its new channel, Mercedes-Benz offers 'hassle-free and transparent' purchase experience to its customers. The direct sales approach is designed to create a win-win experience for both customers and franchisee partners. The franchise partners are primarily responsible for establishing and maintaining customer contacts, developing the market, and facilitating the sales, while Mercedes-Benz will hold and own the inventories, order processing and other sales-related processes. The new approach renders

> the franchise partners free from any liability. This new direct-to-customer distribution model offers transparency and stock visibility to customers through a central order management system. Under this sales and distribution system, standard prices are offered with added benefits managed by the company for each product category. Mercedez-Benz's Indian market is the fourth one to have ROTF after South Africa, Sweden, and Austria. The company invested around ₹60 crores in the entire process. Initial results were very positive as the company received bookings of over 1700 units through the new ROTF model.[12]

Companies should use different sales channels for different-sized business customers—a direct sales force for large customers, a digital strategy or telemarketing for midsize customers, and distributors for small customers—but should be alert for conflict over account ownership. For example, territory-based sales representatives may want credit for all sales in their territories, regardless of the marketing channel used.

Multichannel marketers also need to decide how much of their product to offer in each of the channels. Patagonia views the Web as the ideal channel for showing off its entire line of goods, given that limited space at its retail locations means they can offer only a selection, and even its catalog promotes less than 70 percent of its total merchandise.[13] Other marketers prefer to limit their online offerings, theorizing that customers look to websites and catalogs for a "best of" array of merchandise and don't want to have to click through dozens of pages. REI is a company that has carefully managed its multiple channels.

Mercedes-Benz's novel direct-to-consumer model is turning out to be win-win for the consumer, the franchise partners and the company.
Source: Mark Richardson / Alamy Stock Photo

REI Outdoor equipment supplier REI has been lauded by industry analysts for the seamless integration of its retail store, website, internet kiosks, mail-order catalogs, value-priced outlets, mobile app, and toll-free order number. If an item is out of stock in the store, all customers need to do is tap into the store's internet kiosk to order it from REI's website. Less internet-savvy customers can have clerks place the order for them at the checkout counters. And REI not only generates store-to-Internet traffic but also sends online shoppers into its stores. If a customer browses REI's site and stops to read an REI "Learn and Share" article on backpacking, the site might highlight an in-store promotion on hiking boots. To create a more common experience across channels, the specific icons and information used in ratings and reviews on REI.com also appear on in-store product displays. Like many retailers, REI has found that dual-channel shoppers spend significantly more than single-channel shoppers, and tri-channel shoppers spend even more. For example, one of every three people who buy something online will spend an additional $90 in the store when they come to pick up that purchase.[14]

Multichannel purchases have been found to boost sales, which has been the experience of outdoor equipment supplier REI after it seamlessly integrated its retail, internet, catalog, and phone sales activities.
Source: Darryl Brooks/Alamy Stock Photo

CHANNEL-MANAGEMENT DECISIONS

To design a marketing-channel system, marketers analyze customer needs and wants, establish channel objectives and constraints, and identify and evaluate major channel alternatives. After a company has chosen a channel system, it must select, train, motivate, and evaluate intermediaries for each channel. It must also modify channel design and arrangements over time, including the possibility of expansion into international markets.

ESTABLISHING CHANNEL OBJECTIVES

Marketers should state their channel objectives in terms of the customers they aim to reach, the service output levels they want to provide, and the associated cost and support levels. Under competitive conditions, channel members should arrange their functional tasks to minimize costs and still provide desired levels of service. Usually, planners can identify several market segments based on desired service and choose the best channels for each.

Consumers may choose the channels they prefer based on price, product assortment, and convenience, as well as their own shopping goals (economic, social, or experiential).[15] However, the same consumer may choose different channels for different reasons.[16] Some consumers are willing to "trade up" to retailers offering higher-end goods such as TAG Heuer watches or Callaway golf clubs and "trade down" to discount retailers for private-label paper towels, detergent, or vitamins. Others may browse a catalog before visiting a store or test-drive a car at a dealership before ordering online.

Channel objectives vary with product characteristics. Bulky products, such as building materials, require channels that minimize the shipping distance and the amount of handling. Nonstandard products such as custom-built machinery are sold directly by sales representatives. Products requiring installation or maintenance services, such as heating and cooling systems, are usually sold and maintained by the company or by franchised dealers.

High-unit-value products such as generators and turbines are often sold through a company sales force rather than intermediaries.

Marketers must adapt their channel objectives to the larger environment. When economic conditions are depressed, producers want to move goods to market using shorter channels and without services that add to the final price. Legal regulations and restrictions also affect channel design. For example, U.S. law looks unfavorably on channel arrangements that substantially lessen competition or create a monopoly.

When entering new markets, firms often closely observe what other firms are doing. Auchan, a French retailer with over 3,000 retail outlets worldwide, considered the presence of its French rivals Leclerc and Casino in Poland as key to its decision to enter that market also.[17] Apple's channel objective of creating a dynamic retail experience for consumers was not being met by existing channels, so it chose to open its own stores.

> **Apple Stores** When Apple launched its stores in 2001, many questioned its prospects; *BusinessWeek* published an article titled "Sorry Steve, Here's Why Apple Stores Won't Work." Just five years later, the company was celebrating the launch of its spectacular Manhattan showcase. There are more than 500 Apple retail stores in operation around the world, which employ over 50,000 people. Over 1 million customers visit Apple stores each day worldwide, more than double the attendance at all the Disney Theme Parks around the world combined.[18] Annual sales per square foot were significantly higher than those of Tiffany, Coach, and Best Buy. Any way you look at them, Apple Stores have also been an unqualified success in fueling excitement for the brand. They let people see and touch the products—and experience what Apple can do for them—making it more likely they will become customers. They target tech-savvy customers with in-store product presentations and workshops; a full line of Apple products, software, and accessories; and a "Genius Bar" staffed by specialists who provide technical support, often free of charge. Apple's meticulous attention to detail is reflected in the preloaded music and photos on demo devices, innovative touches such as roving credit-

card swipers to minimize checkout lines, and hours invested in employee training. Employees receive no sales commissions and have no sales quotas. They are told their mission is to “help customers solve problems.” Although the stores initially upset existing Apple retailers and authorized service providers, the company worked hard to smooth relationships, in part justifying its decision as a natural evolution of its online sales channel.[19]

Apple created a dynamic atmosphere in which to experience its full line of products by opening its own stores, where the focus of the sales staff is to help customers solve problems.
Source: Olaf Schuelke/Alamy Stock Photo

More sophisticated companies try to forge a long-term partnership with distributors.[20] The manufacturer clearly communicates what it wants from its distributors in the way of market coverage, inventory levels, marketing development, account solicitation, technical advice and services, and marketing information and may introduce a compensation plan for adhering to the policies.

SELECTING CHANNEL MEMBERS

To customers, the channels are the company. Consider the negative impression customers would get of McDonald's, Shell Oil, or Mercedes-Benz if one or more of their outlets or dealers consistently appeared dirty, inefficient, or unpleasant.

To facilitate channel member selection, producers should determine what characteristics distinguish the better intermediaries—number of years in business, other lines carried, growth and profit record, financial strength, cooperativeness, and service reputation. If the intermediaries are sales agents, producers should evaluate the number and character of other lines carried and the size and quality of the sales force. If the intermediaries are department stores that want exclusive distribution, then their locations, future growth potential, and type of clientele will matter.

Identifying Major Channel Alternatives. Each channel—from sales force to agents, distributors, dealers, direct mail, telemarketing, and traditional retailers—has unique strengths and weaknesses. Sales forces can handle complex products and transactions, but they are expensive. Online retailing is inexpensive but may not be as effective for complex products. Distributors can create sales, but the company loses direct contact with customers. Several clients can share the cost of manufacturers' reps, but the selling effort is less intense than company reps provide.

Based on the number of intermediaries, there are three core distribution strategies: *exclusive*, *selective*, and *intensive* distribution. We discuss these strategies next.

Exclusive distribution severely limits the number of intermediaries. It's appropriate when the producer wants to ensure more knowledgeable and dedicated efforts by the resellers, and it often requires a closer partnership with them. Exclusive distribution is used for new automobiles, some major appliances, and luxury apparel and accessories. When the legendary Italian designer label Gucci found its image tarnished by overexposure from licensing and discount stores, it decided to end contracts with third-party suppliers, control its distribution, and open its own stores to bring back some of the luster.

Both channel partners benefit from exclusive arrangements: The producer obtains more loyal and dependable outlets, and the retailer gets a steady supply of special products and stronger seller support. Exclusive arrangements are legal as long as they do not substantially lessen competition or tend to create a monopoly and as long as both parties enter into them voluntarily.

Exclusive dealing often includes exclusive territorial agreements. The producer may agree not to sell to other dealers in a given area, or the buyer may agree to sell only in its own territory. The first practice increases dealer enthusiasm and commitment. It is also perfectly legal; a seller has no legal obligation to sell through more outlets than it wishes. The second practice, whereby the producer tries to keep a dealer from selling outside its territory, has become a major legal issue.

Selective distribution relies on some but not all of the intermediaries willing to carry a particular product. Unlike exclusive distribution, in which individual retailers do not directly compete with one another (for example, because they are assigned non-overlapping geographic areas), selective distribution might include retailers that compete for the same customers. STIHL is a good example of successful selective distribution.

> **STIHL** STIHL manufactures handheld outdoor power equipment. All its products are branded under one name, and it does not make private labels for other companies. Best known for its chain saws, the company has expanded into string trimmers, blowers, hedge trimmers, and cut-off machines. It sells exclusively to six independent U.S. distributors and six company-owned marketing and distribution centers, which sell to a nationwide network of more than 8,000 independent retail dealers offering service. STIHL also exports to 80 countries and is one of the few outdoor power equipment companies that does not sell through mass merchants,

catalogs, or the internet. It even ran an ad campaign called “Why” that touted the strength and support of its independent dealers with headlines such as “Why is the World’s No. 1-selling brand of chain saw not sold at Lowe’s or The Home Depot?” and “What makes this handblower too powerful to be sold at Lowe’s or The Home Depot?”[21]

STIHL shuns mass merchandisers and limits distribution channels to a half-dozen independent U.S. distributors and the company’s own marketing and distribution centers, which supply independent U.S. retailers and export to 80 countries.
Source: dpa picture alliance archive/Alamy Stock Photo

Intensive distribution places the goods or services in as many outlets as possible. This strategy works well for snack foods, soft drinks, newspapers, candies, and gum—products that consumers buy frequently or in a variety of locations. Convenience stores such as 7-Eleven and Circle K and gas station outlets like ExxonMobil's On the Run survive by providing simple location and time convenience.

Manufacturers are constantly tempted to move from exclusive or selective distribution to more intensive distribution to increase coverage and sales. This strategy may help in the short term, but if not done properly, it can hurt long-term performance by encouraging retailers to compete aggressively. Price wars can then erode profitability, dampening retailer interest and harming brand equity. Some firms do not want their products to be sold everywhere. After Sears acquired discount chain Kmart, Nike pulled all its products from Sears to make sure Kmart could not carry the brand.

To develop a channel, members must commit to each other for a specified period of time. Yet these commitments invariably reduce the producer's ability to respond to change and uncertainty. The producer needs channel structures and policies that provide high adaptability.

Producers are free to select their dealers, but their right to terminate them is somewhat restricted. In general, sellers can drop dealers "for cause," but not if, for example, a dealer refuses to cooperate in a doubtful legal arrangement such as exclusive dealing or tying agreements.

Franchising. An increasingly popular way to grow distribution channels is **franchising**. In a franchising system, individual *franchisees* are a tightly knit group of enterprises whose systematic operations are planned, directed, and controlled by the operation's owner, the *franchisor.* Franchise businesses such as McDonald's, Hampton, Jiffy-Lube, Subway, Supercuts, 7-Eleven, and many others are an integral component of the business landscape.

Franchises are distinguished by three main characteristics:

- The franchisor owns a trade or service mark and licenses it to franchisees in return for royalty payments. For example, McDonald's Corporation owns the intellectual property associated with the McDonald's brand and the logistics associated with operating its franchises.
- The franchisee pays for the right to be part of the system. Start-up costs include rental and lease equipment and fixtures and (usually) a regular license fee. McDonald's franchisees typically invest upward of $1.5 million in total start-up costs and fees. The franchisee then pays McDonald's a certain percentage of sales plus a monthly rent.

- The franchisor provides its franchisees with a system for doing business. McDonald's requires franchisees to attend "Hamburger University" in Oak Brook, Illinois, for two weeks to learn how to manage the business. Franchisees must follow certain procedures in buying materials.[22]

Franchising benefits both parties. Franchisors gain the motivation and hard work of employees who are entrepreneurs rather than "hired hands," as well as the franchisees' familiarity with local communities and conditions, and the enormous purchasing power of being a franchisor. Franchisees benefit from buying into a business with a proven business model and a well-known and accepted brand name. They find it easier to borrow money for their business from financial institutions, and they receive support in areas ranging from marketing and advertising to site selection and staffing.

Franchisees do walk a fine line between independence and loyalty to the franchisor. Some franchisors give their franchisees freedom to run their own operations, from personalizing store names to adjusting offerings and price. Great Harvest Bread believes in a "freedom franchise" approach that encourages its franchisee bakers to create new items for their store menus and to share these with other franchisees if they are successful.[23]

Although franchising is a well-established business practice, it can take different formats depending on the entity sponsoring the franchise. The *manufacturer-sponsored retailer franchise* is the traditional system. To sell its cars, Ford licenses independent businesspeople who agree to meet specified conditions of sales and services. Another system is the *manufacturer-sponsored wholesaler franchise.* Coca-Cola licenses bottlers (wholesalers) in various markets that buy its syrup concentrate and then carbonate, bottle, and sell it to retailers in local markets.

Another form of franchising system is the *service-firm-sponsored retailer franchise,* organized by a service firm to bring its service efficiently to consumers. We find examples in auto rental (Hertz and Avis), fast food (McDonald's and Burger King), and the motel business (Howard Johnson and Ramada Inn). In a dual distribution system, firms use both vertical integration (the franchisor actually owns and runs the units) and market governance (the franchisor licenses the units to other franchisees).[24]

MOTIVATING CHANNEL MEMBERS

A company needs to view its intermediaries the same way it views its end users. It should determine their needs and wants and tailor its channel offering to provide them with superior value.

Carefully implemented training, market research, and other capability-building programs can motivate and improve intermediaries' performance. The company must constantly communicate to intermediaries that they are crucial partners in a joint effort to satisfy end users of the product. Microsoft requires its third-party service engineers to complete a set of courses and take certification exams. Those who pass are formally recognized as Microsoft Certified Professionals and can use this designation to promote their own business. Other firms use customer surveys rather than exams.

Channel Power. Producers vary greatly in their skill in managing distributors. **Channel power** is the ability to alter channel members' behavior so they take actions they would not have taken otherwise.[25] Manufacturers can draw on the following types of power to elicit cooperation:[26]

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

These forms of channel power vary depending on the degree to which they are readily observable. Coercive and reward power are objectively observable; legal, expert, and referent power are more subjective and depend on the ability and willingness of parties to recognize them.

Most producers see gaining intermediaries' cooperation as a huge challenge. They often use positive motivators, such as higher margins, special deals, premiums, cooperative advertising allowances, display allowances, and sales contests. At times, they will apply negative sanctions, such as threatening to reduce margins, slow down delivery, or terminate the relationship. The weakness of this approach is that the producer is using crude, stimulus–response thinking.

In many cases, retailers hold the power. One estimate is that manufacturers offer the nation's supermarkets between 150 and 250 new items each week, of which store buyers reject more than 70 percent. Manufacturers need to know the acceptance criteria that buyers, buying committees, and store managers use. Nielsen interviews found that store managers were most influenced by strong evidence of consumer acceptance, a well-designed advertising and sales promotion plan, and generous financial incentives.

Channel Partnerships. Based on the nature of the relationship among the members of the marketing channel, there are three basic types of channels: conventional channels, vertical marketing systems, and horizontal marketing systems.

Conventional marketing channels consist of an independent producer, wholesaler(s), and retailer(s). Each is a separate business seeking to maximize its own profits, even if this goal reduces profit for the system as a whole. No channel member has complete or substantial control over other members. Channel coordination occurs when channel members are brought together to advance the goals of the channel instead of their own potentially incompatible goals.

Vertical marketing systems, by contrast, include the producer, wholesaler(s), and retailer(s) acting as a unified system. One channel member, the **channel captain**, who is sometimes called a *channel steward*, owns or franchises the others or has so much power that they all cooperate.

Stewards accomplish channel coordination without issuing commands or directives by persuading channel partners to act in the best interest of all.[27]

A channel steward might be the maker of the product or service (Procter & Gamble), the maker of a key component (Intel), the supplier or assembler (Arrow Electronics), or the distributor (W.W. Grainger) or retailer (Walmart). Within a company, stewardship might rest with the CEO, a top manager, or a team of senior managers.

Channel stewardship has two important outcomes. First, it expands value for the steward's customers, enlarging the market or increasing existing customers' purchases through the channel. Second, it creates a more tightly woven and yet adaptable channel in which valuable members are rewarded and the less valuable are weeded out.

Vertical marketing systems arose from strong channel members' attempts to control channel behavior and eliminate conflict over independent members pursuing their own objectives. These systems achieve economies through size, bargaining power, and elimination of duplicated services. Business buyers of complex products and systems value the extensive exchange of information they can offer.[28] Vertical marketing systems have become the dominant mode of distribution in the U.S. consumer marketplace, serving 70 percent to 80 percent of the market. There are three types: corporate, administered, and contractual.

- A **corporate vertical marketing system** combines successive stages of production and distribution under single ownership. For years, Sears obtained more than half the goods it sold from companies it partly or wholly owned. Sherwin-Williams makes paint but also owns and operates 3,500 retail outlets.
- An **administered vertical marketing system** coordinates successive stages of production and distribution through the size and power of one of the members. Manufacturers of dominant brands can secure strong trade cooperation and support from resellers. Thus Frito-Lay, Procter & Gamble, and Campbell Soup command high levels of cooperation from their resellers in the matter of displays, shelf space, promotions, and price policies. The most advanced producer–distributor arrangement for administered vertical marketing systems relies on distribution programming, which builds a planned, professionally managed, vertical marketing system that meets the needs of both manufacturer and distributors.
- A **contractual vertical marketing system** consists of independent firms at different levels of production and distribution integrating their programs on a contractual basis to obtain more

economies or sales impact than they could achieve alone.[29] Sometimes thought of as "value-adding partnerships," contractual vertical marketing systems come in three types: (1) In *wholesaler-sponsored voluntary chains*, wholesalers organize voluntary chains of independent retailers to help standardize their selling practices and achieve buying economies. (2) In *retailer cooperatives*, retailers take the initiative and organize a new business entity to carry on wholesaling and possibly some production. (3) In *franchise organizations*, a channel member (franchisor) might link several successive stages in the production–distribution process.

Many independent retailers that have not joined a vertical marketing system have developed specialty stores serving special market segments. The result is a polarization in retailing between large vertical marketing organizations and independent specialty stores, which creates a problem for manufacturers. They are strongly tied to independent intermediaries but must eventually realign themselves with the high-growth vertical marketing systems on less attractive terms. Furthermore, vertical marketing systems constantly threaten to bypass large manufacturers and set up their own manufacturing. The new competition in retailing is no longer between independent business units but between whole systems of centrally programmed networks (corporate, administered, and contractual) competing against one another to achieve the best cost-economies and customer response.

Horizontal marketing systems involve two or more unrelated companies putting together resources or programs to exploit an emerging marketing opportunity. Each company lacks the capital, know-how, production, or marketing resources to venture alone, or it is afraid of the risk. The companies might work together on a temporary or permanent basis or create a joint venture company.

For example, many supermarket chains have arrangements with local banks to offer in-store banking. Citizens Bank has more than 500 branches in supermarkets, making up a little less than half of its branch network. Citizens' staff members in these locations are more sales oriented and more likely to have some retail sales background than staff in the traditional brick-and-mortar branches.[30]

EVALUATING CHANNEL MEMBERS

Producers must periodically evaluate intermediaries' performance against such standards as sales-quota attainment, average inventory levels, customer delivery time, treatment of damaged and lost goods, and cooperation in promotional and training programs. A producer will occasionally discover it is overpaying particular intermediaries for what they are actually doing. One manufacturer that had been compensating a distributor for holding inventories found its goods were being held in a public warehouse at its own expense. Producers should set up functional discounts in which they pay specified amounts for the trade channel's performance of each agreed-upon service. Underperformers need to be counseled, retrained, motivated, or terminated.

A new firm typically starts as a local operation selling in a fairly circumscribed market, using a few existing intermediaries. Identifying the best channels might not be a problem; the problem is often to convince the available intermediaries to handle the firm's line.

If the firm is successful, it might branch into new markets with different channels. It might sell directly to retailers in smaller markets and through distributors in larger markets. It might work with general-goods merchants in rural areas and with limited-line merchants in urban areas. It may choose to create its own online store to sell directly to customers. It might grant exclusive franchises or sell through all willing outlets. In one country, the firm might use international sales agents; in another, it might partner with a local firm.

Early buyers might be willing to pay for high-value-added channels, but later buyers will switch to lower cost channels. Small office copiers were sold first by manufacturers' direct sales forces, later through office equipment dealers, still later through mass merchandisers, and more recently by mail-order firms and internet marketers. In short, the channel system evolves as a function of local opportunities and conditions, emerging threats and opportunities, company resources and capabilities, and advancements in technology.

No channel strategy remains effective over the whole product life cycle. In competitive markets with low entry barriers, the optimal channel structure will inevitably change over time. New technologies have created digital channels undreamed of years ago. The change could mean adding or dropping individual market channels or channel members or developing a totally new way to sell goods. When new competition from Best Buy and Costco forced one-third of Leica's U.S. dealers to close, the high-end camera maker decided to open its own stylish stores to appeal to serious photographers.[31]

A producer must periodically review and modify its channel design and arrangements.[32] The distribution channel may not work as planned, consumer buying patterns change, the market expands, new competition arises, innovative distribution channels emerge, and the product moves into later stages in the product life cycle.[33]

To add or drop individual channel members, the company needs to make an incremental analysis. A basic question is "What would the firm's sales and profits look like with and without this intermediary?" Perhaps the most difficult decision is whether to revise the overall channel strategy. Avon's door-to-door system for selling cosmetics was modified as more women left the house and entered the paid workforce.

CHANNEL COOPERATION AND CONFLICT

No matter how well channels are designed and managed, there will be some conflict, if only because the interests of independent business entities do not always coincide. **Channel conflict** occurs when one channel member's actions prevent another channel member from achieving its goal. Companies distributing their offerings through different channels are likely to face a certain level of channel conflict. In this context, a manager's goal is to reduce the channel conflict by minimizing the frictions between channel members.

A common source of channel conflict is a manufacturer's desire to sell directly to its customers, bypassing its traditional channel partners. By opening its own retail stores, Apple created a challenge for many of its authorized solution-provider and channel partners by effectively “stealing” many of their current customers. Likewise, in the business-to-business space, Apple has stepped up its direct sales force in enterprise accounts, including forming direct partnerships with companies such as Cisco and IBM that have effectively limited the scope of services provided by many of their independent solution providers.[34]

Here we examine three questions: What types of conflict arise in channels? What causes conflict? What can channel members do to resolve it?

THE NATURE OF CHANNEL CONFLICTS

To be able to effectively manage channel conflict, managers must understand the key types of channel conflict and the factors that often lead to conflicts among channel partners.

Types of Channel Conflict. Suppose a manufacturer sets up a vertical channel consisting of wholesalers and retailers, hoping for channel cooperation and greater profits for each member. Despite a desire by all parties to cooperate, horizontal, vertical, and multichannel conflict can occur.

- **Horizontal channel conflict** occurs between channel members at the same level. For example, franchisees might provide poor customer service, which harms brand value and results in poor consumer reviews that damage sales across all other channels. For example, some Pizza Inn franchisees complained about other franchisees cheating on ingredients, providing poor service, and hurting the overall brand image.
- **Vertical channel conflict** occurs between different levels of the channel. For example, a vertical conflict is likely to occur when a manufacturer sells to wholesalers and retailers directly. It is likely to be especially intense when the manufacturer sells directly to one of a wholesaler’s largest customers. For example, when Estée Lauder set up an online store to sell its Clinique and Bobbi Brown brands, some department stores reduced the space it allotted to the company’s products.
- **Multichannel conflict** exists when the manufacturer has established two or more channels that sell to the same market. For example, multichannel conflict is likely to occur when a restaurant

chain allows two franchise locations within close proximity to each other. Multichannel conflict can be especially intense when the members of one channel get a lower price (based on larger-volume purchases) or work with a lower margin. When Goodyear began selling its popular tire brands through Sears, Walmart, and Discount Tire, it angered its independent dealers. Goodyear eventually placated them by offering exclusive tire models not sold in other retail outlets.[35]

Causes of Channel Conflict. Even though each channel conflict has unique antecedents and consequences, there are several general factors that can contribute to the creation of a channel conflict. Some of the most common reasons for channel conflict are as follows:

- *Goal incompatibility.* Channel conflict can stem from the conflicting goals of different channel members. For example, a manufacturer may want to achieve rapid market penetration through a low-price policy. Dealers, in contrast, may prefer to work with high margins and pursue short-run profitability.
- *Differences in strategies and tactics.* Channel conflict may also occur when channel members adopt different strategies and tactics to achieve their goals. The manufacturer may be optimistic about the short-term economic outlook and want dealers to carry higher inventory, while the dealers may be pessimistic. In the beverage category, it is not uncommon for disputes to arise between manufacturers and their distributors about the optimal advertising strategy.
- *Power imbalance.* Greater retailer consolidation—the 10 largest U.S. retailers account for more than 80 percent of the average manufacturer's business—has led to increased retailer influence that often spawns channel conflict. Walmart, for example, is the principal buyer for the products of many manufacturers, including Disney, Procter & Gamble, and Revlon, and is able to command reduced prices or quantity discounts from these and other suppliers.[36] Power imbalance can also be caused by distributors' reliance on the manufacturer. The fortunes of exclusive dealers, such as auto dealers, are profoundly affected by the manufacturer's product and pricing decisions.
- *Unclear roles and rights.* Territory boundaries and credit for sales often produce conflict. HP may sell laptops to large accounts through its own sales force, but its licensed dealers may also be trying to sell to large accounts.[37]

MANAGING CHANNEL CONFLICT

Some channel conflict can be constructive and lead to better adaptation to a changing environment, but too much is dysfunctional.[38] The challenge is not to eliminate all conflict, which is impossible, but to manage it better. Reprimands, fines, withheld bonuses, and other remedies can help minimize channel conflict.[39] Common mechanisms for effective conflict management include strategic justification, dual compensation, superordinate goals, employee exchange, joint memberships, and co-optation, as well as diplomacy, mediation, or arbitration and legal recourse.[40]

- *Strategic justification.* In some cases, a convincing strategic justification that channel members serve distinctive segments and do not compete as much as they might think can reduce potential for conflict. Developing special versions of products for different channel members—branded variants—is a clear way to demonstrate that distinctiveness.[41]
- *Dual compensation.* A company can mitigate channel conflict by paying existing channel members for sales made through new channels. When Allstate started selling insurance online, it agreed to pay agents a 2 percent commission for face-to-face service to customers who got their quotes online. Although lower than the agents' typical 10 percent commission for offline transactions, this commission did reduce tensions.[42]
- *Superordinate goals.* Channel members can come to an agreement on the fundamental or superordinate goal they are jointly seeking, whether it is survival, market share, high quality, or customer satisfaction. They usually do this best when the channel faces an outside threat, such as a more efficient competing channel, an adverse piece of legislation, or a shift in consumer desires.
- *Employee exchange.* Exchanging personnel between two or more channel levels can reduce channel conflict. GM's executives might agree to work for a short time in some dealerships, and some dealership owners might work in GM's dealer policy department. Thus, participants can grow to appreciate each other's point of view.
- *Joint memberships.* Marketers can encourage joint memberships in trade associations. Good cooperation between the Grocery Manufacturers of America and the Food Marketing Institute, which represents most of the food chains, led to the development of the universal product code (UPC). The associations can consider issues between food manufacturers and retailers and resolve them in an orderly way.
- *Co-optation.* An organization can win the support of its channel members by including its leaders in advisory councils, boards of directors, and the like. If the organization treats invited leaders seriously and listens to their opinions, co-optation can reduce conflict, although the initiator may need to compromise its policies and plans to win outsiders' support.
- *Diplomacy, mediation, and arbitration.* When conflict is chronic or acute, the parties may need to resort to stronger means. Diplomacy takes place when each side sends a person or group to meet with its counterpart to resolve the conflict. Mediation relies on a neutral third party skilled in conciliating the two parties' interests. In arbitration, two parties agree to present their arguments to one or more arbitrators and accept their decision.
- *Legal recourse.* Rather than pursuing other strategies, a channel partner may choose to rely on legal means to resolve the conflict.[43] When Coca-Cola decided to distribute Powerade thirst quencher directly to Walmart's regional warehouses, 60 bottlers complained that the practice would undermine their core direct-store-distribution duties and filed suit. A settlement allowed

for the mutual exploration of new service and distribution systems to supplement the direct-store-distribution system.[44]

MANAGING MARKET LOGISTICS

Market logistics includes planning the infrastructure to meet demand and then implementing and controlling the physical flows of materials and final goods from points of origin to points of use to meet customer requirements at a profit. Physical distribution starts at the factory. Managers choose a set of warehouses (stocking points) and transportation carriers that will deliver the goods to final destinations in the desired time or at the lowest total cost.

Physical distribution has now been expanded into the broader concept of supply chain management. **Supply chain management** starts before physical distribution and includes strategically procuring the right inputs (raw materials, components, and capital equipment), converting them efficiently into finished products, and dispatching them to the final destinations. An even broader perspective looks at how the company's suppliers themselves obtain their inputs.

The supply chain perspective can help a company identify superior suppliers and distributors and then help it improve productivity and reduce costs. Firms with top supply chains include Apple, McDonald's, Amazon.com, Unilever, Intel, Procter & Gamble, Toyota, Cisco Systems, and Samsung Electronics.[45] Some companies choose to partner with and outsource to third-party logistics specialists for help with transportation planning, distribution center management, and other valued-added services that go beyond shipping and storing.

Studying market logistics leads managers to find the most efficient way to deliver value. For example, a software company traditionally produced and packaged software disks and manuals, shipped them to wholesalers, which shipped them to retailers, which sold them to customers, who brought them home to install the software on their computers. Market logistics offered two superior delivery systems. The first let customers download the software directly onto their computers. The second allowed the computer manufacturer to download the software onto its products. Both solutions eliminated the need for printing, packaging, shipping, and stocking millions of disks and manuals and have quickly become the norm of the industries.

MARKET-LOGISTICS OBJECTIVES

Many companies state their market-logistics objective as “getting the right goods to the right places at the right time for the least cost.” Unfortunately, this objective provides little practical guidance. No system can simultaneously maximize customer service and minimize distribution cost. Maximum customer service implies large inventories, premium transportation, and multiple warehouses, all of which raise market-logistics costs. Nor can a company achieve efficient market logistics by asking each market-logistics manager to minimize his or her own logistics costs.

Minimizing market-logistics costs can influence the overall market success of an offering and, in some cases, can even be counterproductive. Consider these examples:

> The traffic manager favors rail shipment over air shipment because rail costs less. However, because the railroads are slower, rail shipment ties up working capital longer, delays customer payment, and might send customers to competitors that offer faster service.
>
> The shipping department uses cheap containers to minimize shipping costs. Cheaper containers lead to a higher rate of damaged goods and customer ill will.
>
> The inventory manager favors low inventories. This increases stock-outs, back orders, paperwork, special production runs, and high-cost, fast-freight shipments.

Given these trade-offs, managers must make decisions on a total-system basis. The starting point is to study what customers require and what competitors are offering. Customers are interested in on-time delivery, help meeting emergency needs, careful handling of merchandise, and quick return and replacement of defective goods.

The wholesaler must then research the relative importance of these service outputs. For example, service-repair time is very important to buyers of copying equipment. Xerox developed a service delivery standard that "can put a disabled machine anywhere in the continental United States back into operation within three hours after receiving the service request." It then designed a service division of technicians, parts, and locations to deliver on this promise.

The company must also consider competitors' service standards. It will normally want to match or exceed these, but the objective is to maximize profits, not sales. Some companies offer less service and charge a lower price; other companies offer more service and charge a premium price.

The company ultimately must establish some promise it makes to the market. Some companies define standards for each service factor. One appliance manufacturer promises to deliver at least 95 percent of the dealer's orders within seven days of order receipt, to fill them with 99 percent accuracy, to deal with inquiries about order status within three hours, and to ensure that merchandise damaged in transit does not exceed 1 percent.

MARKET-LOGISTICS DECISIONS

The firm must make four major decisions about its market logistics: How should we handle orders (order processing)? Where should we locate our stock (warehousing)? How much stock should we hold (inventory)? and How should we ship goods (transportation)?

Order Processing. Most companies are trying to shorten the **order-to-payment cycle**—that is, the time between an order's receipt, delivery, and payment. This cycle has many steps, including order transmission by the salesperson, order entry and customer credit check, inventory and production scheduling, order and invoice shipment, and receipt of payment. The longer this cycle takes, the lower the customer's satisfaction and the lower the company's profits.

Warehousing. Most companies must store finished goods until they are sold because production and consumption cycles rarely match. In order to make use of existing resources and speed transportation times, some companies have decentralized their inventory. For example, to better manage inventory, many department stores (such as Nordstrom and Macy's) now ship online orders from individual stores. More stocking locations mean that goods can be delivered to customers more quickly, but warehousing and inventory costs are higher. Alternatively, to reduce costs, a company might centralize its inventory in one place and use fast transportation to fill orders.

Some warehouses are now taking on activities formerly done in the plant, including product assembly, packaging, and construction of promotional displays. Moving these activities to the warehouse can save costs and match the offerings more closely to demand.

Inventory. Salespeople would like their companies to carry enough stock to fill all customer orders immediately. However, this is not cost effective. Inventory cost increases at an accelerating rate as the desired level of customer satisfaction approaches 100 percent. Management needs to know how much sales and profits would increase as a result of carrying larger inventories and promising faster order fulfillment times and then make a decision.

As inventory draws down, management must know at what stock level to place a new order. This stock level is called the *order (*or *reorder) point.* An order point of 20 means reordering when the stock falls to 20 units. The order point should balance the risks of stock-out, where the company runs out of a particular good and is unable to meet customer demand, against the costs of overstock, where the company has to bear the cost of carrying an inventory for a long period of time. The other decision is how much to order. The larger the quantity ordered, the less frequently an order needs to be placed.

The company needs to balance order-processing costs and inventory-carrying costs. *Order-processing costs* for a manufacturer consist of *setup costs* (costs of setting up the processes required to produce one item) and *running costs* (operating costs when production is running) for the item. If setup costs are low, the manufacturer can produce the item often, and the average cost per item is stable and equal to the running costs. If setup costs are high, however, the manufacturer can reduce the average cost per unit by producing a long run and carrying more inventory.

Order-processing costs must be compared with *inventory-carrying costs,* which include storage charges, cost of capital, taxes and insurance, and depreciation and obsolescence. Carrying costs might run as high as 30 percent of inventory value and are higher the larger the average stock carried. This means marketing managers who want to carry larger inventories need to show that incremental gross profits will exceed incremental carrying costs.

Companies are using different strategies to manage their inventory costs. One approach involves keeping slow-moving inventory items in a central location and carrying fast-moving items in warehouses closer to customers. Alternatively, a company can switch to carrying near-zero inventory and acquiring stock based on orders. In addition to saving on warehousing costs, this approach—referred to as **just-in-time inventory management**—helps the company improve its cash flow. Thus, by asking consumers to pay for the purchased items in advance, a company can use customers' money to pay suppliers to ship the product or the necessary components.

Despite its obvious cost advantages, the just-in-time inventory management approach has an important drawback in that it assumes uninterrupted distribution logistics. Simply put, just-in-time inventory does not have sufficient flexibility should anything go wrong, as it often does—whether it's a dock strike in California, an earthquake in Japan, or political turmoil in North Africa and the Middle East. In an interconnected world, one weak link, if not properly managed, can bring down the entire supply chain. The limitations of just-in-time inventory management came prominently into focus during the coronavirus pandemic, as disruptions in procurement, manufacturing, and shipping resulted in demand outstripping supply in many categories, culminating in product shortages and longer delivery times than usual.

To balance the effectiveness and the cost-efficiency of their logistics, companies need to re-evaluate their logistics networks periodically to guard against extreme demand shocks. Accordingly, many companies are securing additional warehousing space and modernizing their distribution operations. Merchants are also moving their warehouses closer to large population centers to ensure not only that they have the required inventory on hand but also that they are able to deliver it to their customers faster than the competition.

Transportation. Transportation choices affect product pricing, on-time delivery performance, and the condition of the goods when they arrive, all of which affect customer satisfaction.

In shipping goods to its warehouses, dealers, and customers, a company can choose rail, air, truck, waterway, or pipeline. Shippers consider such criteria as speed, frequency, dependability, capability, availability, traceability, and cost. For speed, the prime contenders are air, rail, and truck. If the goal is low cost, then the choice is water or pipeline.

Shippers are increasingly combining two or more transportation modes, thanks to containerization. **Containerization** consists of putting the goods in boxes or trailers that are easy to transfer between two transportation modes. The term *piggyback* describes the use of rail and trucks; *fishyback,* water and trucks; *trainship,* water and rail; and *airtruck,* air and trucks. Each coordinated mode offers specific advantages. For example, piggyback is cheaper than trucking alone but provides flexibility and convenience.

Shippers can choose private, contract, or common carriers. If the shipper owns its own truck or air fleet, it becomes a *private carrier.* A *contract carrier* is an independent organization selling transportation services to others on a contract basis. A *common carrier* provides services between predetermined points on a scheduled basis and is available to all shippers at standard rates. Some contract carriers are investing and innovating to create strong value propositions.

> **Contract Carriers** With so many transportation options available, shipping firms are constantly competing to cut costs, improve services,

and offer even more value to their customers. Copenhagen-based Maersk Group is the world's largest global shipper, with around 550 container ships and 225 tankers. To improve efficiency, the firm commissioned 20 of the largest ships ever built. Costing $185 million each, these giant ships can cost effectively carry 18,000 containers, emitting 50 percent less CO_2 in the process. Schneider, one of the country's largest full-truckload freight haulers with more than $3 billion in revenue, developed a fleet-wide "tactical simulator" that has saved the company tens of millions of dollars. Besides helping in the crucial day-to-day route scheduling of drivers, the simulator has also helped with specific decisions ranging from when to raise prices for certain customers to how many drivers to hire (and where). Little changes can make big differences for shippers. Global logistics leader UPS calculated that by having its drivers use a fob instead of a key to operate its trucks, it is cutting out on average 1.7 seconds per stop, or 6.5 minutes per day, saving an estimated $70 million a year in the process.[46]

To reduce costly handing at arrival, some firms are putting items into shelf-ready packaging so they don't have to unpack them from a box and place them individually on a shelf. In Europe, Procter & Gamble has used a three-tier logistics system to schedule deliveries of fast- and slow-moving goods, bulky items, and small items in the most efficient way. To reduce damage in shipping, the size, weight, and fragility of the item must be reflected in the crating technique used and the density of foam cushioning. With logistics, every little detail must be reviewed to see how it might be changed to improve productivity and profitability.

Looking to improve efficiency, global shipper Maersk Group commissioned giant ships able to carry thousands of containers while substantially cutting CO_2 emissions.

Source: Greg Balfour Evans/Alamy Stock Photo

marketing INSIGHT

Understanding the Showrooming Phenomenon

Consumers have always shopped around to get the best deal or broaden their options, and now e-commerce and m-commerce (selling via mobile phone and tablet) offer them a new twist. **Showrooming** lets consumers physically examine a product and collect information in a store but make their actual purchase from the retailer later online—or, in the store's least desirable outcome, from a different retailer altogether, typically to secure a lower price.

Showrooming has been given a boost by smartphones. Thanks to their mobile devices, consumers in stores have never been better equipped to decide whether they should buy. One study showed that more than half of U.S. mobile phone users, especially younger ones, have used their phones, while shopping, to ask for purchase advice from a friend or family member or to look for reviews or lower prices.

Retailers used to worry about getting consumers into the store, but experts note that they now need to worry instead about selling to consumers who are bringing other stores in with them. Amazon's Price Check phone app, for instance, allows shoppers to instantly compare prices while in a brick-and-mortar store. Online retailers that mobile users can tap offer traditional brick-and-mortar chains serious competition because of their wider selections, lower prices (often with no taxes), and 24/7 convenience.

Addressing showrooming head-on, Best Buy and Target announced they would permanently match the prices of online retailers. Others have more closely linked their stores and websites in response to the trend. Walmart, Macy's, and Best Buy allow in-store pickup of online orders and returns of online purchases.

Many retailers are making the in-store experience more informative and rewarding. Guess, PacSun, and Aéropostale are equipping in-store sales staff with iPads or tablets for collecting more in-depth product information to share with shoppers. Shoppers enrolled in loyalty programs can also quickly download their purchase histories, product preferences, and other useful background.

The main goal of all these efforts is to hold on to the customer. One study found that 70 percent of a showrooming audience was more likely to buy from retailers with well-designed websites and apps, strong multichannel support, and price comparisons via QR (Quick Response) codes. Shifting sales from a store to online can actually be more profitable for a retailer if it prevents the customer from buying elsewhere.[47]

SUMMARY

1. Most producers do not sell their goods directly to final users. Between producers and final users stands one or more marketing channels, with a host of marketing intermediaries performing a variety of functions. Distribution channels are sets of interdependent organizations participating in the process of making a product or service available for use or consumption.
2. Companies use intermediaries when they lack the financial resources to carry out direct marketing, when direct marketing is not feasible, and when they can earn more by doing so. Effective channel management calls for selecting intermediaries and training and motivating them. The goal is to build a long-term partnership that will be profitable for all channel members.
3. Members of the marketing channel perform a number of key functions. Some of these functions (storage and movement, title, and communications) constitute a *forward flow* of activity from the company to the customer; others (ordering and payment) constitute a *backward flow* from customers to the company; and some (information, negotiation, finance, and risk taking) occur in both directions.
4. Manufacturers have many alternatives for reaching a market. They can sell direct or use one-, two-, or multi-level channels. Deciding which type(s) of channel to use calls for analyzing customer needs, establishing channel objectives, and identifying and evaluating the major alternatives, including the types and numbers of intermediaries involved in the channel.
5. A growing number of companies employ *multichannel distribution*, using two or more marketing channels to reach customer segments in one market area. In addition, companies are increasingly employing digital distribution strategies, selling directly online to customers or through e-merchants who have their own websites. Multichannel distribution calls for the development of an integrated distribution strategy where the activities involved in selling through one channel are

aligned with the activities involved in selling through one or more other channels.

6. To design a marketing-channel system, marketers analyze customer needs and wants, establish channel objectives and constraints, and identify and evaluate major channel alternatives. Based on the number of intermediaries, there are three core distribution strategies: exclusive, selective, and intensive distribution. Following the choice of channel intermediaries, a company must select, train, motivate, and evaluate its channel partners.
7. An increasingly popular form of growing distribution channels is franchising. In a franchising system, individual franchisees are a tightly knit group of enterprises whose systematic operations are planned, directed, and controlled by the operation's innovator, the franchisor. Franchisees benefit from buying into a business with a well-known and accepted brand name. They find it easier to borrow money for their business from financial institutions, and they receive support in areas ranging from marketing and advertising to site selection and staffing.
8. A company needs to motivate its channel partners by identifying their needs and wants and tailor its channel offering to provide them with superior value. An important factor here is channel power, which reflects the ability to alter channel members' behavior so they take actions they would not have taken otherwise. Based on the nature of the relationship between the members of the marketing channel, there are three basic forms of channel coordination that can help motivate channel partners: conventional channels, vertical marketing systems, and horizontal marketing systems.
9. All marketing channels have the potential for conflict and competition resulting from goal incompatibility, poorly defined roles and rights, perceptual differences, and interdependent relationships. Companies can try to manage conflict through dual compensation, superordinate goals, employee exchange, co-optation, and other means.
10. Producers of physical products and services must decide on market logistics—the best way to store and move goods and services to market destinations and to coordinate the activities of suppliers, purchasing agents, manufacturers, marketers, channel members, and customers. Major gains in logistical efficiency have come from advances in information technology.

11. The supply-chain approach to managing market logistics can help a company identify superior suppliers and distributors, as well as help it improve productivity and reduce costs. The firm must make four major decisions about its market logistics: How should we handle orders (order processing)? Where should we locate our stock (warehousing)? How much stock should we hold (inventory)? and How should we ship goods (transportation)?

marketing INSIGHT

ZARA

Zara began in 1975 when Amancio Ortega and Rosalia Mera opened their first store in Galicia, Spain. The original store sold low-priced lookalikes of high-end, popular fashion products. Zara’s business model of imitating the latest fashion and providing their designs at low prices appealed to Spanish consumers. In the next eight years, Zara expanded to nine more stores in popular shopping centers in Spain. During this period, Ortega had created a design, manufacturing, and distribution process he called “instant fashion,” which could respond to fashion trends very quickly. Using this process, Zara spent the next decade expanding into the global market, which included the United States, France, Belgium, and Sweden. After achieving similar success with its expansions, Zara eventually became the world’s largest apparel retailer.

source: Mira/Alamy stock Photo

Zara famously views clothes as a “perishable commodity,” something that should be enjoyed for a couple of weeks or months. Zara’s apparel appeals to consumers who are looking to keep up with all the latest fashion trends. When a new style becomes popular, Zara can imitate it and release a new collection in less than two weeks. Other fashion companies can take as long as six months to put out a new design. Unlike companies that focus on quantity over style, Zara does the opposite. Zara releases over 12,000 styles per year; this wide variety creates a greater likelihood that consumers will find an item they like.

The majority of Zara’s designs stay on shelves for only three to four weeks. The constant refreshing of styles on store shelves also incentivizes customers to visit Zara stores more frequently. This can be seen in consumer behavior in Central London. Consumers visit other clothing stores and average of up to four times per year. Zara’s customers visit shops an average of 17 times per year. The full racks of clothes always give shoppers something new to choose from. Zara produces lower quantities of each style to create artificial scarcity, which makes their offerings seem more desirable and luxurious. An added benefit of this scarcity is that if a style is not successful, Zara doesn’t have to dispose of a high volume of inventory.

Zara's clothing starts with the design process, which includes a heavy focus on consumer input. Store employees and managers listen to customers' comments and suggestions and take note of what they're wearing in stores. Design teams visit universities, nightclubs, shopping centers, and other areas frequented by fashion trendsetters to observe new fashion choices that could potentially be successful. The trends team follows popular fashion bloggers and tracks Zara customers for new insights. The data gathered by Zara's research team span new trends that differ by gender, culture, and season. This allows Zara to create product offerings that reflect the different needs of the global market. Zara offers smaller-sized clothing in Japan, hijab headscarves and long dresses for women in Arab countries, and more breathable apparel for countries in South America. Understanding the varied needs of its customers allows Zara to release a wide variety of successful styles on a frequent basis.

What enables Zara to release new collections quickly is its fast and vertically integrated supply chain. Zara's in-house production facilities allow the company to control processes such as dyeing, fabric cutting, and processing. When new designs come into the factory, clothing items are manufactured, processed, and in stores within 15 days. Zara tends to manufacture only fashionable and trendy items that have a short selling cycle. Items that tend to stay on shelves, like basic T-shirts and pants, are outsourced to low-cost suppliers in Asia. When items are released and fail to meet sales expectations, factories quickly cancel production. Zara's fast and efficient flow of information and data can result in large fluctuations in orders. Zara can adjust orders up to 40 to 50 percent, avoiding potential overproduction. Zara's flexible production process attempts to offer consumers what they want to buy at any given time.

Zara combines an understanding of its customers with a highly efficient supply chain to create its global success. The company is aware that the consumer is an invaluable resource in the design of its trendy apparel and collections. Coupling this insight with a well-managed and highly profitable inventory strategy, Zara aims to stay on top of fashion retailing.[48]

Questions

1. Would Zara's model work for other retailers? Why or why not?
2. What can Zara do to ensure successful growth around the world that maintains the same level of speed and instant fashion?
3. Who are Zara's biggest competitors? What should Zara do to build, enhance, and sustain its competitive advantage?

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TITAN

Titan Industries Limited, established in 1984 as Titan Watches, is a joint venture between the Tata Group and the Tamil Nadu Industrial Development Corporation (TIDCO). In its 37 years of rich and classic legacy, Titan has positioned itself as a trusted, fashion brand, and currently stands as the fifth largest watch manufacturer in the world. The company's contemporary designs, outstanding advertisements and smart channel management have proven to be key contributors to Titan's success in building a strong brand.

Beginning with watches positioned as fashion accessories, Titan has emerged a leading player in multiple segments with frontrunner brands—Titan for watches, Tanishq, Mia and Carat Lane for jewelry, Titan Eye+ for eyewear. The company also expanded its product portfolio by launching 'SKINN'– a perfume brand and 'Fast track' – fancy watches and eyewear for the youth. Quality products and innovative design backed by strong branding, retailing and service support have been key factors in making Titan a lifestyle major.

Since its inception, Titan adopted an aggressive production and distribution strategy, revolving around its strong value system, and to build that classic image the company followed a tailor-made marketing approach. Its product portfolio consists of a vast variety of contemporary products, exclusively designed to fit the requirements of its target segments. To reach out to its multi-segment target audience, Titan established a very extensive distribution network, designed to complement its product and positioning strategy. Titan’s channel management strategy sets itself a class apart. Aligned with the value system of the company as well as with its products, the company adopted a multi-layered distribution system designed to cater to the high volume market. Titan set up exclusive showrooms titled ‘The World of Titan’ designed to create a premium shopping experience for its customers. It expanded its channel with franchisee operated exclusive outlets replicating the ‘The World of Titan’ feel with complete control over major functions such as store design, location, recruitment, and training of the staff. Titan introduced other channel members in its network while expanding through multi-brand watch outlets and department stores for further market penetration. To reach out to other newly added markets in semi-urban areas and small towns, the company added Titan shops and Titan distributors, while opting for digital channels to capture the millennials.

Source: Tanishq©Titan Company Ltd, used with permission

Titan manages one of the largest retail networks in India through its well-crafted distribution network. It has products for all, and therefore, the channel member and distribution strategy are designed accordingly. 'The World of Titan' and 'Tanishq' are designed for its high-end customers looking for elegant fashion wear accessories and jewelry[49]. The company ensures quality services, product differentiation, standard pricing, and value proposition in both categories of outlets viz. company-owned and franchisee-owned showrooms. In the beginning, Titan preferred company-owned showrooms over franchisees to establish the retailing concept while exercising greater control over its distribution. Today the number of franchisee-owned showrooms have outnumbered the company-owned showroom. All its showrooms exclusively retail Titan brands.

For the price-sensitive and quality-conscious market, Titan introduced the ‘Titan Shops’. This category is now known as ‘Titan Time Zone’. It is a semi-exclusive distribution category, which focuses mainly on Titan brands. Over 70 per cent of the products are Titan brands and while the remaining nearly 30 per cent products belong to competing brands. These outlets attract customers who want to compare Titan with other brands before buying a watch. Multi-brand stores draw the price-sensitive middle class customers in the semi-urban markets.

The third category of Titan’s multi-mode distribution includes ‘Titan dealers’. Two categories of dealers help the company reach out to its expanded market segments. First, the traditional dealers carry Titan brands along with competing brands to capture the low-end segments. Second, the non-traditional dealers that serve the high-end customers through restaurants, gift shops and boutiques, and carry exclusive products.[50]

Titan has strangthened its online presence to cater to the millennials. The company supports its omnichannel presence amongst youth with brands like Fast track and Mia. Titan has come up with facilities like selling through video calls during the Covid-19 pandemic. The entire distribution network has been refurbished looking at the changing needs of its customers. It has also started offering the home delivery option to ensure seamless availability of its products.[51]

Today, Titan is among the country’s largest retailers with 1,078 stores and 1.5 million sq ft of retail space, operating through multi-mode distribution. Its franchisee-led model has helped the business to be very asset light. The very ‘face’ of the company -The World of Titan showrooms – remains an integral part of the Titan family and every care is taken to ensure that similar “customer bonding” takes place with these franchisee-owners as the company’s valuable primary customers. The partnership approach with franchisees has brought significant success to Titan, which has continued to enjoy rapid growth in sales and profitability. From fun-filled annual business meets to a rewards system for target achievement, this relationship although different, also helps sustain a long-term mutually profitable association. Every aspect of this relationship is reviewed and appraised in a systematic manner through processes designed for only that purpose. Like Nikhil Vora of Sixth Sense Ventures comments on Titan, *"They really are the masters of 2,000 sq ft retail,.*[52]

Questions

1. What are the key aspects of Titan's distribution model?
2. What are the key benefits of franchising for Titan's brands viz. Titan, Titan Eye+, Tanishq, Mia, etc. and their franchisees?
3. How much leeway should Titan offer to individual franchisees in deciding on the store design merchandise, staff training and advertising? Should Titan take a centralized approach, or should it let franchisees adapt their strategy to local conditions?