Channel Decision

This is made by a combination of intuition and analysis, and the exercise of judgment. The decision is complicated by the interdependencies existing between relevant factors. While it is difficult to quantify the many trade-offs associated with channel decisions, certain tools can be applied to them. Cost analysis techniques will give reasonable estimates of each channel cost. System analysis involves trade-offs in time, service and costs in order to maximize profits in the long run. Quantitative comparisons are made between alternative production runs, inventory holding levels, transport modes, customer service standards, order transmission, processing systems, etc. This must involve computer-oriented modelling techniques owing to the large number of variables to be considered.

In recent years, significant environmental changes have taken place:

1. Trend towards a short-order economy - the increase in inventory has meant that the best decision is to order frequently, forcing the primary supplier to carry the necessary inventory.

2. Rapid expansion of product lines - this generates obsolescence and stock availability problems as well as inventory imbalance.

3. Price differentials and discounts - legally speaking, these have to be cost-justified.

4. Competitive strategies - at one time they centred on product features and price; now the emphasis is on indirect competition such as outperforming competitors on logistic planning and customer service.

The members of a marketing channel are interconnected by several different factors:

1. The product line from manufacturer to end-user

2. The flow of ownership from member to member

3. The cash flow as payments are made by one member to another

4. The exchange of information between channel members

5. The advertising and sales promotion directed by channel members towards other members or end-users.

Dealer selection

Dealer selection is the first task in the process of dealer management. It is obvious that a firm has to be very careful in selecting its dealers. It has to ensure that those selected for dealership possess certain essential qualifications. Some of these qualifications are common ones, irrespective of the product lines involved; others are product specific. Financial strength, business capacity, creditworthiness and salesmanship form part of the common qualifications.

Qualifications/Attributes

A detailed checklist of the qualifications/attributes to be looked into while selecting dealers is as follows:

• Business reputation/standing

• Business capacity

• Salesmanship

• Expertise / experience in the line

• Financial capacity and willingness to invest in the line

• Creditworthiness

• Capacity to offer assortments of products and services required by the customers

• Capacity and willingness to extend credit to customers

• Capacity to provide storage facilities, showrooms, shops, service workshops, salesmen and service personnel commensurate with the business

• Positive attitude towards the company

• Good relations with:

- Consumers
- Opinion leaders in the area
- Government officials and others (as applicable, depending on the nature of the business.

The criteria can be modified appropriately, depending on the product characteristics, the marketing environment and the objectives of the firm. In practice, however, it is difficult for any firm to locate dealers possessing all the qualifications and attributes enumerated in the chart. Obviously, one has to compromise. Out of the available candidates, the firm has to select those who have the potential to be a good dealer. Then, it should build them into effective and strong dealers through a sustained process of development. If the product requires a specialised distributor, as in the case of industrial products, the choice must be made accordingly;

Firms, which are well established in the market and those that which possess certain unique strengths in terms of product, brand, service, etc., will enjoy a wider choice when they set out to appoint dealers. Their reputation and brand equity will pull in a large number of applicants who are above average in the required attributes. In contrast, for firms yet to be established, the choice base will be small. Such firms may have to initially accept those who prepared to take up the dealership and build a good network over a period of time.

Effective dealer recruitment depends in the first place on the firm's ability to attract applications from the right candidates. Advertisements will no doubt be of help in this regard. But they must be developed carefully. The companies and ad agencies must have the expertise needed for developing effective dealer recruitment ads.

'Dealer Wanted' Ads

The first test of a good 'dealer wanted' ad is no doubt its 'attention grabbing' strength among the prospects. The second test is the ad's ability to coax the stronger ones among them to respond to the proposition being made. In the present times, with more brands crowding the marketplace, the premium on dealers' shelf space is increasing exponentially. It needs a well- thought out and well-written dealer ad to bring in the right response. The communication must put across the proposition forcefully; while many companies give 'dealer wanted' ads, only a few do a good job of it. Cited below are a few effective 'dealer wanted' ads.

Evaluating the Alternatives and Selecting the Best

With the completion of the foregoing steps, the number of alternatives would have narrowed down considerably; the firm must evaluate these alternative designs and choose the best among them. Actually, two distinct evaluations-an economic evaluation and a conceptual evaluation-may be necessary.

Economic evaluation; balancing cost, efficiency and risk: Cost and efficiency are the two main parameters in economic evaluation. Often, though not necessarily, the two are directly proportional. The firm has to rate the risk associated with the different alternatives. The firm's choice is a compromise among the three parameters. The first step here is the determination of the sales volume that can be obtained through each alternative design. Second, the costs of selling that volume through that alternative have to be assessed. In other words, the firm determines the unit cost of selling in each of the alternatives. The firm chooses the one, which is attractive from the cost vs. efficiency angle and is also relatively less risky.

Conceptual evaluation; flexibility and controllability: Conceptual evaluation is also equally important. It has to be used for assessing the flexibility and controllability of the alternative. It is possible that economic evaluation points to one particular alternative as superior, while conceptual evaluation gives it a low rating. For example, a marketer-oriented channel design may show merit in terms of unit cost of selling, but may show severe limitations from the standpoints of controllability/flow of market feedback as well as requirements of long-term market development. With conceptual evaluation, the firm can also check out whether the alternative is compatible with its business objectives.

Some Vital Aspects in Finalising the Channel

The job is not over with the selection of the basic channel design. Within a given design, different arrangements are possible. It means that further decisions are needed. The important aspects to be decided are:

- Channel intensity
- Number of tiers
- The appropriate variant within the design

Choosing the Channel Intensity

While two firms may go for the same channel design, they may need different intensities. It depends on the position of the firm its objectives and strategies, its sales, profits, and market coverage, present and projected, and its resources. For example, Maruti and Mitsubishi India, being passenger car firms operating in the same market, may opt for similar channel design. But they may settle for different channel intensity; Maruti has a massive network consisting of 144 sales outlets, 175 dealer workshops and 750 authorised service stations across India. Mitsubishi has not gone in for similar intensity.

In fact, a firm would be ill advised to adopt without question the channel intensity of another firm, even if the latter were the industry leader. What suits one may not suit the other. Blindly following another firm's channel pattern and intensity will land the firm in trouble. Recent experience of some well-known MNC FMCG firms in India will clearly amplify this point. Below table shows how choosing channel intensity wrongly landed P & G and Nestle in trouble.

Levels of Distribution Intensity

Intensity Level	Objective	Number of Intermediaries
Intensive	Achieve mass market selling Used for convenience goods	Many
Selective	Work with selected intermediaries Used for shopping and some specialty goods	Several
Exclusive	Work with single intermediary Used for specialty goods and special industrial equipments	One

Real Life Case Scenario

P & G and Nestle

Procter & Gamble (P&G), Nestle and Hindustan Unilever (HUL) are FMCG companies operating in India. P & G and Nestle thought that it would be appropriate for them to follow the HUL channel model. It was only after losing some precious money and time that they realised that they neither needed no could afford channel intensity on the HUL pattern.

HUL maintains a channel consisting of over a million retail points and 7,500 distributors, the largest in the country. The arrangement has suited HUL very well.

HUL has a large basket of products and brands covering every possible price/ demographic/geographic segment. At the last count, it had over 110 actively selling brands. HUL's marketing channel has to naturally cover every income group and every geographical segment in the country and its annual sales turnover in FY 19-20 was Rs. 39,518 crores.

P&G and Nestle were different from HUL in all these respects.

Moreover, the HUL model comes with its associated costs. Setting up marketing networks in rural areas and small towns takes both time and money. HUL had incurred the associated investment and had absorbed a dent on its bottom line on this account over the past several years, and it is not affected currently by this strategy.

After learning the lessons the hard way, P&G decided to forget the HUL model and drastically downsized its distribution. It now confined itself to Class I and Class II towns, and exited practically all rural areas. Only for some select products like Vicks Action-500, it continued its distribution in rural areas.

It also reduced the number of pack sizes in which it offered its products as another measure towards reducing distribution costs.

Nestle too decided to move away from the HUL model. Earlier, embracing the HUL model, it had gone in for high channel-intensity. For example, between 1993 and 1996, Nestle had added on 350,00 retail points to its distribution network in India, the bulk of them in smaller towns and rural areas.

As its sales were nowhere near the HUL level, it could not sustain the channel intensity. It reduced it considerably. It also compressed its product mix and product line. It now concentrated on products in which it was traditionally strong—milk products and beverages—and weeded out the low-profit products from the portfolio.

It also went in for tighter market targeting and limited its attention to urban population. In fact, it limited its focus to roughly half of the urban population.

With these moves, it could reduce the cost of servicing the channel. Its new policy was to be on perpetual guard in the matter of channel intensity, limiting it to the level warranted by its sales and profits present and planned.

Choosing the Number of Tiers Correctly

The second decision concerns the number of tiers. How many tiers should the channel have? This issue is related in a way to channel intensity; In a majority of cases, the choice will be between single tier and two tiers, while in a few cases, firms may find it necessary to go in for a three-tier channel. When a firm opts for a sole-selling agency or marketer, the latter will be have their own channel arrangement and the tiers that operate under them automatically become a part of the firm's channel.

The decision depends on a number of factors. In a given business, a particular channel pattern might have taken roots and there may be some advantage in going along with the established trade pattern. The product characteristics are perhaps the most important consideration. For example, for selling passenger cars, a firm need have only a single-tier distribution channel. Here, the intermediaries at one level can effectively link the maker buyer. In a product like toothpaste, or cosmetics, or cigarettes it may be necessary to have a two or three-tier channel pattern in view of the mass nature of the product. It may be difficult to achieve adequacy of market coverage in such products, with just a single tier of marketing intermediaries.

Comparative merits of single-tier and two-tier channel: The single-tier and two tier channel patterns have their associated advantages and disadvantages. The single-tier pattern provides better motivation to each member in the channel, as in such a pattern the trade discount is available in full measure to the retailer. The pattern also brings in savings to the firm by the avoidance of multiple transport and handling. The firm can also service all the outlets directly in this pattern. But, the pattern involves greater administrative burden for the firm. It will have to perform many functions that could otherwise be passed on to the channel. It will have to increase the number of field storage points and the size of sales force to make up for the absence of the wholesale middlemen. The pattern may also sometimes result in inadequate market coverage. The two-tier pattern helps quicker outflow of stocks and more intensive coverage of the market. But, it results in lower profits to retailers, as the available trade margin has to be shared between two tiers. It also weakens the principal's control over the outfit compared with a single-tier pattern.

So, the choice depends on the context. The governing principle is that the chosen channel must have the capability to sell the product and to provide the required market coverage. It should also ensure that the user gets the products with the minimum of effort or strain on his part. And it must be cost-effective. The channel must also be amenable to the control of the company to the extent required for operating the marketing system.

In recent years, as a general trend, the number of tiers in the distribution channels is getting shorter. Businesses that used to have a three-tier structure earlier now have a two-tier structure and those with a two-tier structure earlier are now trying to manage with a single- tier channel. And often, the axe falls on the stockists. Asian Paints, again, is an example. It chose, as a matter of conscious policy, a single-tier channel-going directly to the retail trade.

Selecting Appropriate Variant within a Given Design

Usually, within a given channel design different variants can be thought of. For example, firm A and firm B may opt for the same channel design consisting of conventional wholesalers and retailers. Still, their approaches within the model can vary from one another. Firm A may opt for a wholesaler-weighted system, while firm B for a retailer-weighted system. For example, Nirma Chemicals distributes Nirma soap with a wholesaler-weighted system. In contrast, HLL distributes its Lifebuoy in the same market through a retailer-weighted system. Nirma off-loads the product on the wholesalers at a larger discount; the retailers buy the product from the wholesalers. HLL reaches out directly to a large number of retailers, using wholesalers, C&F agents to the extent necessary.

The two variants have their associated advantages and disadvantages. For instance the wholesaler-oriented system obviates the need for a large sales force, thereby resulting in considerable savings in related costs. But, brand building may suffer somewhat in that system. The firms have to study in detail the trade-off between the two approaches and have to see which one would best suit the firm.

An Eye on the Future is Essential

Once a channel structure is created and channel members are put in place and channel compensations are streamlined, it will be difficult for the firm to exit from that structure and put an alternative in its place. Therefore, as a general rule, an eye on the future is essential while adopting a channel system and structure. The example of P&G clearly illustrates the difficulties involved in altering an ongoing channel structure.

Real Life Case Scenario

P&G

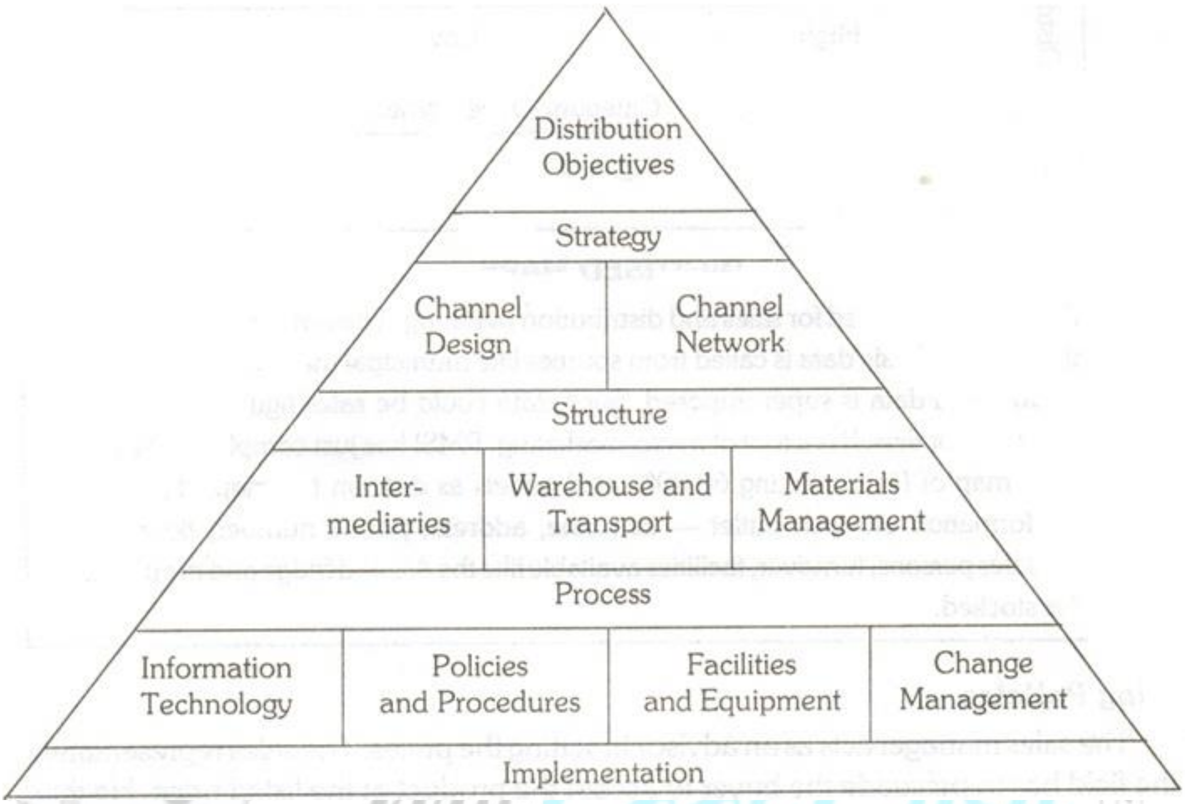
As mentioned earlier, P&G had embraced a highly intensive, two-tier channel structure in India. It was more or less akin to the channel structure of HLL. Over the year, it become clear to P & G that it did not need such a structure, as in business growth and pattern of sale, it differed from HLL. P & G then went in for a reorganisation of the channel set-up. It has to face several problems.

P & G had earlier gone in for nearly 200 stockists and 4,000 dealers all over the country. But sales had remained limited. A large number of the stockists and dealers were not notching up enough sales. In other words, P & G's channel productivity had become low. The company was incurring a disproportionately large cost on channel. Moreover, the company's sales were coming primarily from the urban market, as this market alone was willing to pay the premium price, which P & G normally charged for its Products. P & G then downsized and revamped its channel structure, drastically pruning the number of stockists. In the revised scheme, it appointed state-wise sole distributors and derecognised more than 150 ongoing stockists in the bargain. At the retail level too, thousands of dealers became a casualty.

P & G also went in for the ECP (efficient consumer response) approach. ECP focuses on containing costs and improving bottom lines. In the ECP approach stocks are replenished at the retail shop at more frequent intervals. This enables the retailers to operate with smaller inventories. And consequently, a cut in retailer's margin would be in order.

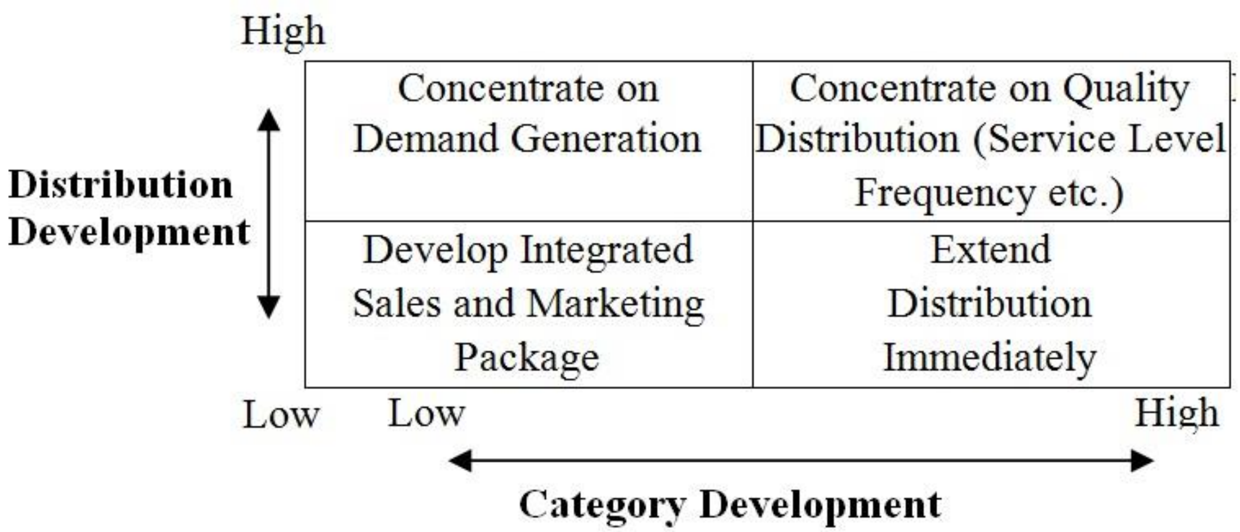
(Source: Economic Times)

The Anderson Consulting Distribution Strategy Pyramid



Distribution Development Index (DDI) and Category Development Index (CDI)

Whether to extend distribution or not is a function of the relative category development in the market. If the market penetration is high, there cannot be increased off take by increasing availability beyond a point. If the market penetration is low, we should analyse why the penetration is low before increasing availability. We have two concepts - Distribution Development Index that is defined as the availability of our brand/category in the market relative to that of a benchmark brand category and Category Development Index that is defined as the per capita consumption of the category in the market relative the national per capita consumption of the category. The relative level of DDI and CDI determine the extent of opportunity to extend the distribution.



One Unified System

For the optimization of the physical distribution task, all elements of physical distribution/marketing logistics, such as transportation, warehousing and inventory management, must be handled as a single, unified system. In the same way the firm has to handle wholesaling, retailing and other forms of selling as one unified system and not as separate entities. The linkage among them in terms of functions, costs and efficiency being quite strong, looking at them as independent entities will lead to sub-optimization of the channel management task as a whole. Compensation provided to the different tiers has also to be properly intertwined, since the functions performed by the different tiers are inter. twined.

Building Channel System by Bottom-up Method

The purpose of having marketing channels is to serve customer needs effectively. This means that the prime task in channel design is to determine the type of retailers who are best suited to serve customer needs in the specific context and develop the distribution system by the bottom-up method. Once the type of retailers suited for the context is determined, the wholesaling arrangement that would best suit the chosen retail arrangement can be chosen and put in place.

Creating and administering the channel

Fixing the channel design is only one part of channel management. Creating the channel and administering it effectively is the other, and bulkier, part of the job. After deciding the design of the channel and the number of tiers in the channel, the firm has to decide the number of members needed in each tier and their locations. It has to select suitable persons establishments and appoint them as stockists, distributors and dealers, as the case may be. It has to administer them, service them and motivate them.

Trade Relations Mix must Provide Satisfaction to both Dealer and Principal

The name of the game is to ensure that the trade relations mix provides satisfaction to the dealer as well as the principal. The firm must offer a viable business proposition to the dealer. That is the baseline, It must also remember that dealers act more as a purchasing agent for the consumers than as a selling agent for the principal. And, it must hence enthuse the dealers by supplying products/brands, which they would be happy to purchase on behalf of their customers.

Servicing and Administering the Dealers

Dealers expect effective servicing from the firm. Prompt supply of the product is one part of effective servicing. Prompt supply of the product helps the dealers not only to achieve larger sales, but also faster turnover and lower cost on inventory carrying. Technical support is the other part. Technical support must be forthcoming promptly from the firm wherever necessary. In any bazaar, one can see several cases of retailers switching their loyalty from one company to another purely on the basis of their servicing standard.

Real case scenario

Effective servicing; example of Electrolux: In the white goods business, Electrolux has scored an edge through effective servicing of dealers. They have picked up one crucial aspect in servicing-replenishment of stocks-and have scored high. They have enabled their dealers to achieve larger sales and simultaneously reduce their inventor. Now, they can draw their supplies from a ring of warehouses around the country and receive the stocks within 24 hours. Electrolux has actually reached a point where its dealers need not carry any inventory at all; the company delivers the products directly to the consumer, once the dealer enters the order on his computer, which is connected to company's stock points. Earlier, the dealers had to wait for two weeks or more; they had to carry heavy inventory; to avoid 'lost sales' due to 'stock outs'.

Regular visits by field force

Largely, the field sales force of the company, C&F agents and stockists provides dealer servicing. The dealers expect regular visits by the field sales force, so that seated in their shop they can have all their problems addressed. The dealers also expect to be kept updated on all vital matters relating to the business. This is possible only if the salesman visit the dealers regularly.

Securing Shelf Space and Merchandising Support from Dealers

Securing shelf space and merchandising support from dealers is another important aspect of dealer management. By enlisting the willing cooperation of the dealers in the merchandising effort, the firm derives multiple benefits. Effective merchandising accelerates the buying process as it serves as an on-the-spot reminder to the consumer to buy. A quick glance at the way in which the dealer aids/point of purchase promotion materials supplied by a firm are used in a retail shop, can help one judge the firm's dealer management.

Real Life Case Scenario

Indian FMCG industry

In the contemporary Indian context, getting shelf space and merchandising and display support from the retail outlets is of special significance as competition among brands is fast building up at the retail level. For example, in CTV market since a number of firms compete for the limited shelf space available at the retail shops, the ones who score in this matter enjoy an overall edge in marketing.

Even big firms and major brands have to fight for shelf space: With the growing competition and the explosion in branded FMCG products, the premium on shelf space has been going up steadily: The competition for grabbing shelf space usually becomes more intense during stagnant market conditions. Even big firms and well-known brands have to earn their shelf space and display the hard way; they are not in a position to demand it as a matter of right from the retailers. For example, some time back, even a firm like HLL was not in a position to demand from its retailers' shelf space and display arrangement for its internationally acclaimed brand Denim, by merely citing that it was a Lever product and an international brand. Nor could it get it by touting its bazaar power of a million retail outlets. The dealers wanted to be convinced about the consumer preference for the brand before he considered it for shelf space and display. Moreover he now has the choice of a whole host of products brands with international affiliations and he could pick and choose the products/brands to which he would allot shelf space.

Many companies are now running special communication programmes with a view to acquainting retailers with their products and brands, and convincing them of the benefit that would accrue to them if they patronised them. Companies are also now forced to meet a major part of the expenses involved in display in the shops. In fact, they are even expected to meet the expenses of general decoration of the shops. ITC, for example, has been earmarking a substantial portion of its promotional budget to the decoration of retail outlets. The company now sets up at its cost special counters, which add considerable glamour to the shop and serve as point of sale advertising.

Today, in most companies, merchandising accounts for more than 15 % of the total marketing spend. Many companies are also devising their own quality control checks on merchandising fronts. Kellogg has about 20 staffers doing the rounds of the outlets once every fortnight. And, at Pepsi, the merchandising teams stir out every two or three months and, even more frequently during the peak season, carrying with them scissors, cello tapes, dusters, nails, board pins, hammers, thread and, of course, the usual point-of-purchase (POP) material. They clean the bottles, dust the racks, put up new posters and rearrange the bottles so that the brand fails the customer.

Ensuring Right Store Image

The competitive edge a firm derives from its retailers extends far beyond shelf space, merchandising and display. The store can be a total communication tool for the company. We shall be discussing the communication role of marketing channels in detail in the chapter on Marketing Communications. Suffice to point out here that the retail points are not mere outlets form where the products flow out. They serve as communication tools as well. It is a fact that consumers patronise certain stores and discard certain others. The store image does the trick. Today, more and more companies are realising the communicative significance of the stile image and are concentrating their attention on the 'store image' of their retail shops.

It was mentioned earlier that in many businesses the marketing war is fought and won at the dealer level. Better servicing of the dealers, better communication and better motivation and training bring in superior dealer loyalty. And, with this loyalty, the firm can win markets. A firm enjoying superior dealer loyalty usually gets a bigger slice of the market.

It is aptly said that a wise firm gets a good band of dealers and good dealers settle down with a wise firm. And a wise firm is one that provides right motivation to its dealers.

Review of the Dealer Network as a Whole

In addition to performance appraisal of individual dealers, the firm must also carry out periodic reviews of the dealer network as a whole. Removal of weaknesses in the network is the objective of such a review. All such weaknesses must be overcome if the channel has to function as a vital instrument of marketing.