Channel-Design Decisions

Although distribution decisions need not precede other marketing decisions, they are a powerful influence on the rest of the marketing mix. Channel decisions are critical because they determine a product’s market presence and buyers’ accessibility to the product. Channel decisions have additional strategic significance because they entail long-term commitments. It is usually easier to change prices or promotion than to change marketing channels.

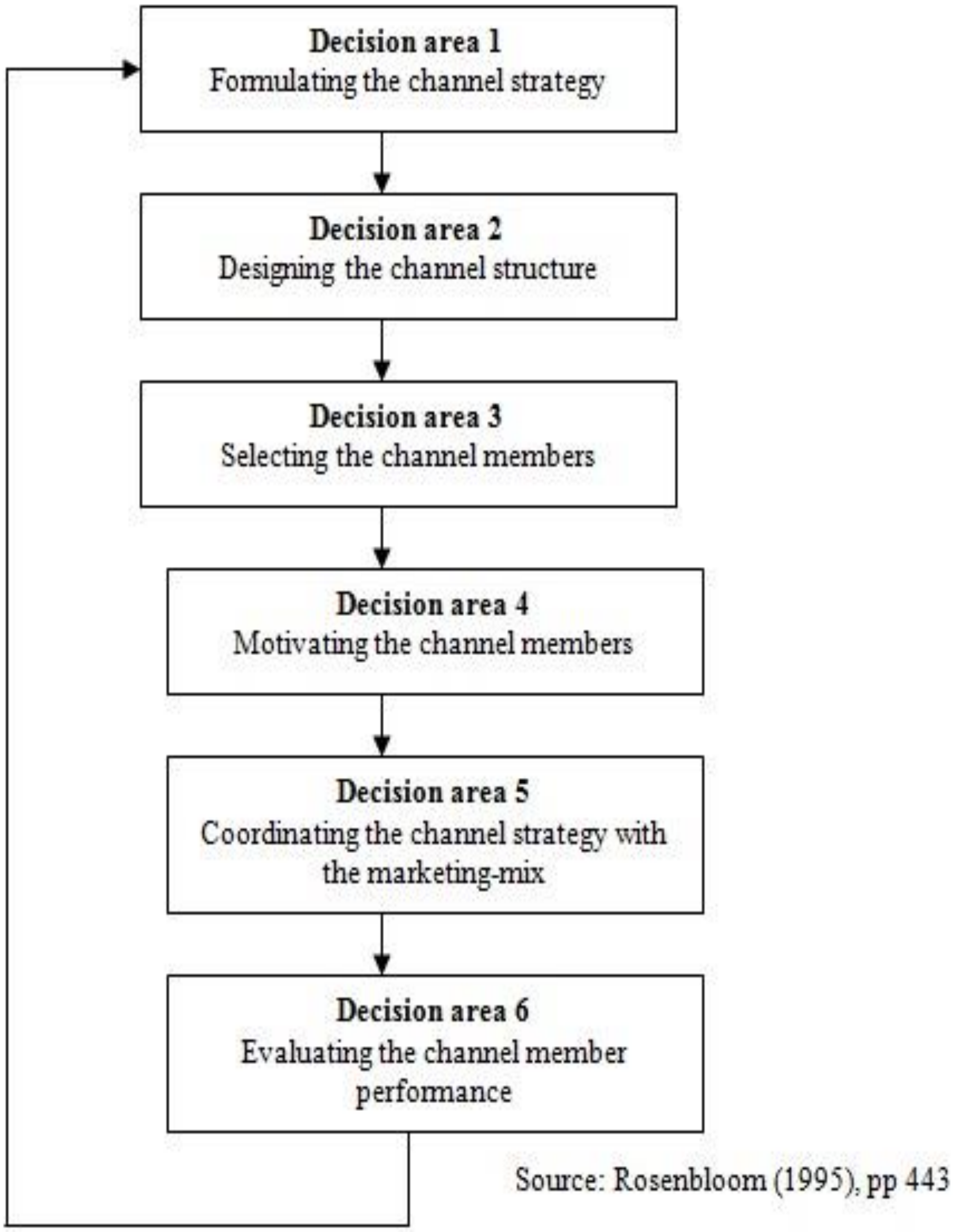
The 'distribution system' refers to the entire marketing process, and not just the physical product distribution. It is a set of interdependent groups and individuals concerned with transferring specific goods or services from the original producer or supplier to the final user or consumer.

Distribution channels are essentially sets of relationships where the parties being involved have to:

- Know each other's aims, policies and procedures
- Be aware of their planning horizons and management styles
- Be willing to accept tasks as well as impose them on others

The most effective distribution channels are those where the distributor's interests are made to coincide with the producer's interests. Before any commitment is made, the producer needs to be certain of the distributor's business aims, attitudes and customer franchise. It pays to remember that your distributors are customers too, and have the option to buy elsewhere. Distributors may take on some or all of the tasks involved in getting goods or services from the producer's door to the consumer’s threshold. Transferring part of the company’s image to the distributor implies that decisions taken by the middleman must be reviewed and should be of a long-term nature.

Rosenbloom identified 6 major decision areas in channel management.



The marketing channel challenge involves two major tasks:

(1) To design the right channel

(2) To implement that design.

The design step involves segmenting the market, identifying optimal positioning responses to segments' demands, targeting the segments on which to focus the channel's efforts, and establishing (in the absence of a pre-existing channel) or refining (in the presence of a pre-existing channel) the channels to manage in the marketplace. The implementation step requires an understanding of each channel member's sources of power and dependence, an understanding of the potential for channel conflict, and a resulting plan for creating an environment 'where the optimal channel design can be effectively executed on an ongoing basis. This outcome is called channel coordination.

A typical distribution strategy comprises of the following stages:

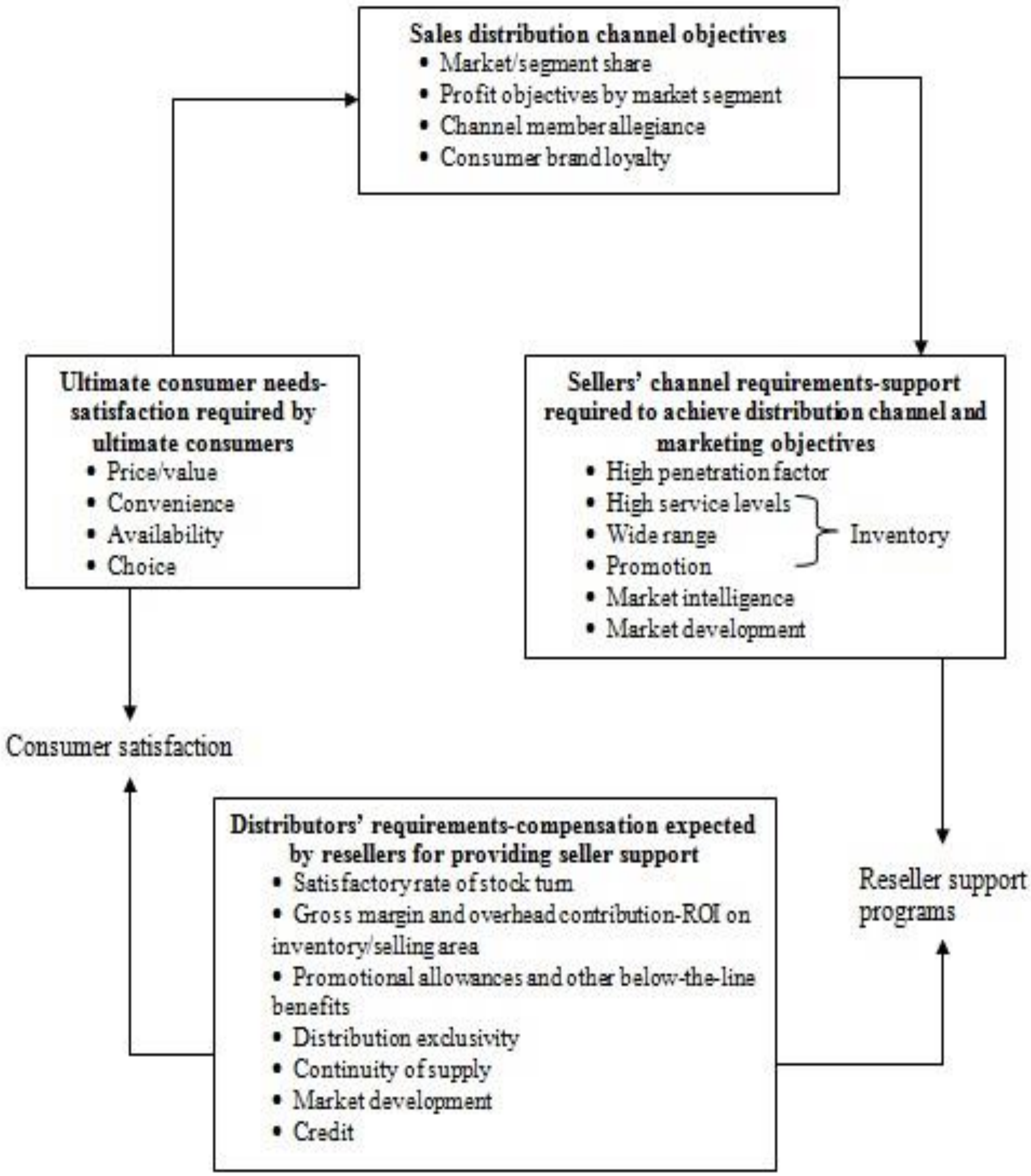
1. Discussing and determining distribution policy
2. Setting distribution channel objectives
3. Reviewing available channel options
4. Researching market conditions that affect channel choice:
   - The local market environment
   - Consumer and trade attitudes
   - The financial climate
   - Characteristics of physical distribution facilities
   - Internal management capabilities
5. Selecting the most suitable channel
6. Choosing business partners as distributors

Establishing objectives and constraints:

Channel objectives should be decided keeping in mind the targeted service output levels. Under competitive conditions, channel institutions should arrange their functional tasks to minimise total channel costs with respect to desired levels of service outputs. Effective planning will determine which markets to serve and the best channel to reach to them most optimally. Here are some observations:

1. Channel objectives vary with product characteristics.
   - Perishable products (having very short shelf life) require more direct marketing so that not much time is lost between manufacturer and customer. The daily newspapers (after 3 hours in the morning, newspaper is wastepaper, isn't it?) require very fast delivery.
   - Bulky products such as building materials require channels that minimise the shipping distance and the amount of handling in the movement from producer to consumer.
   - Non standardised products such as custom-built machinery and specialised business forms are sold directly by company sales representatives.
2. Channel design must take into account the strengths and weaknesses of different types of intermediaries.
3. Channel design is influenced by the competitors' channels.
4. Channel design must adapt to the larger environment. Under depressing economic conditions, producers want to move their goods to market using shorter channels and without nonessential services that add to the final price of the goods.

McDonald made useful distinction between sellers' distribution objectives, sellers' requirements of middlemen and distributors' requirements of sellers.



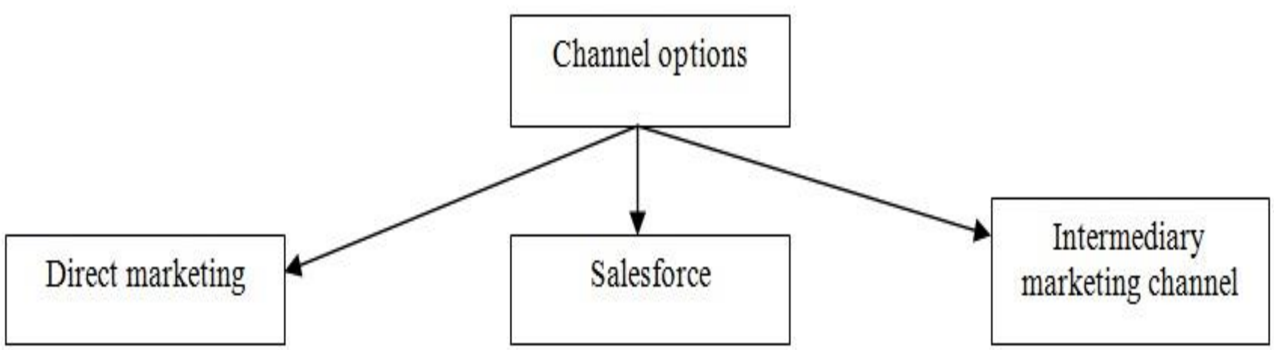
Source: McDonald (1995), pp. 324

Identifying major channel alternatives

After a company has defined its target market and desired positioning, it should identify its channel alternatives. A channel alternative is described by 3 elements:

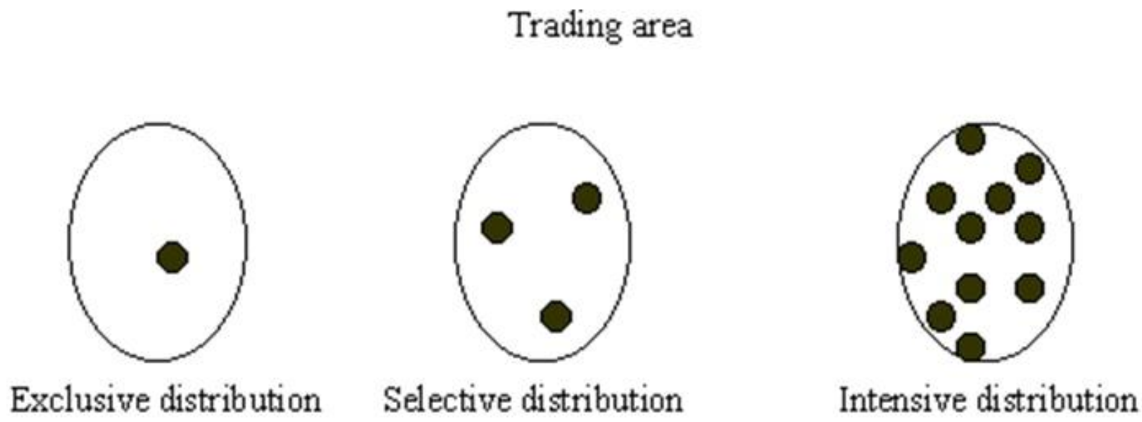
- Company sales force: Expand the company's direct sales force. Assign sales representatives to territories to contact all prospects in the area or develop separate sales forces for the different industries.
- Manufacturers' agency: Hire manufacturers' agents in different regions or end-use industries to sell the new equipment.
- Industrial distributors: Find distributors in different regions or end-use industries who will buy and carry the device. Give them exclusive distribution, adequate margins, product training and promotional support.

Doyle suggested that there are 3 generic channel options as illustrated below.



Source: Doyle (1994), pp. 318

After selecting a marketing channel, the company must decide on the number of intermediaries to be used at each channel level to provide the best target market coverage. The distribution intensity is the number of marketing intermediaries at each level of the marketing channel, which depends on nature of product and type of target customers. There are 3 major levels of distribution intensity:



Source: Cravens (1991), pp 428

Intensive distribution:

It consists of the manufacturer placing the products in as many outlets as possible at each level of the channel to distribute a product. Convenience products such as bread, milk, newspapers, soft drinks, FMCG products (such as toothpaste, washing powder, soap, shampoo etc.) require this type of distribution so that whenever a consumer needs to purchase such type of products that are less expensive, purchased frequently and requires little shopping effort, they are readily available to him or her at all possible outlets. Thus you can find newspapers and magazines from street vendors, newspaper stands, grocery stores and other outlets.

Selective distribution:

It involves the use of more than a few but less than all of the intermediaries who are willing to carry a particular product. The shopping goods and durable goods such as automobiles and electronic appliances. Because such products are more expensive than convenience goods, consumers spend more time visiting retail outlets to compare prices, designs, styles and other features. It is normally used by established companies and also by new companies seeking distributors. It enables the producer to gain adequate market coverage with more control and less cost than intensive distribution.

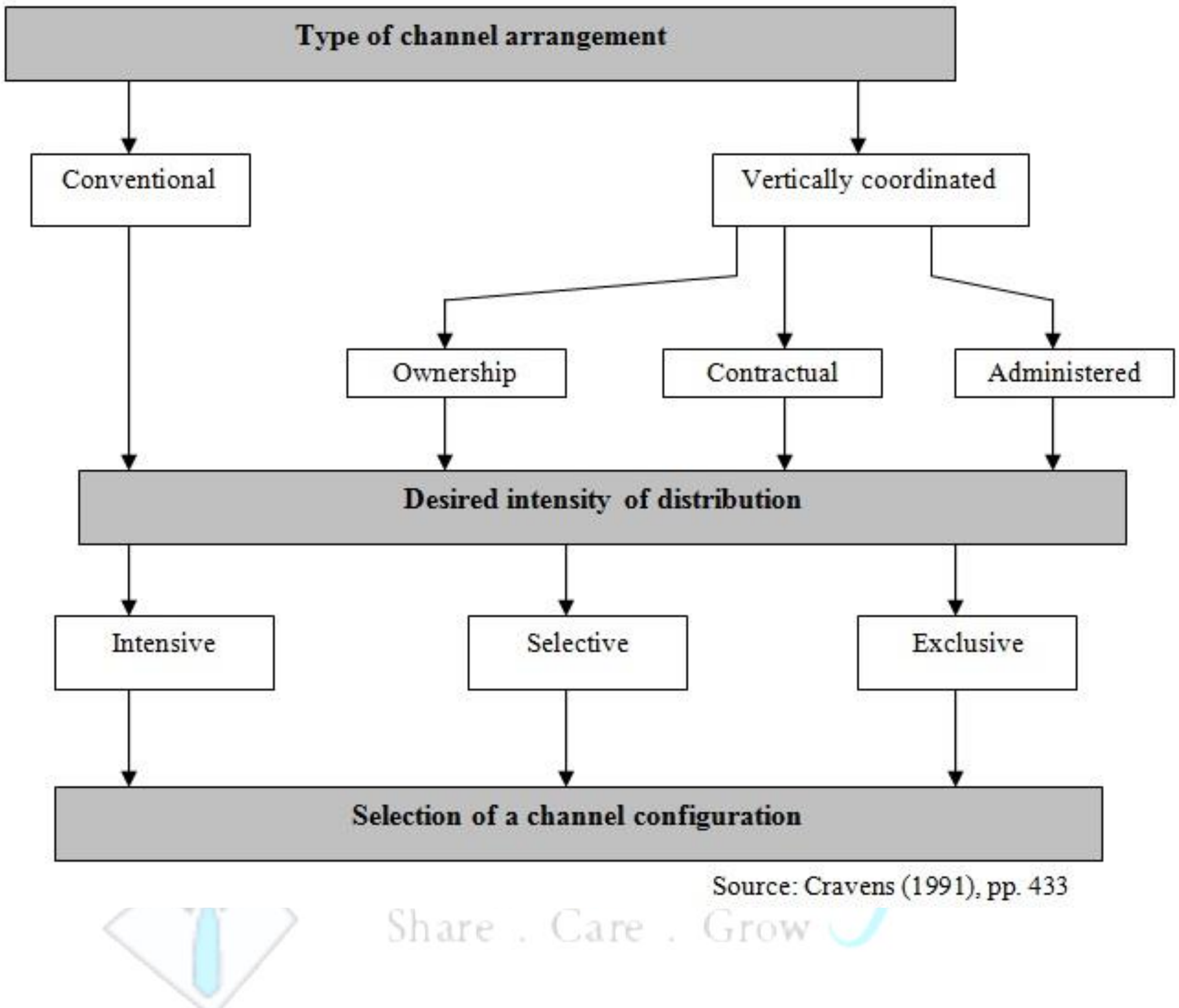
Exclusive distribution:

It means limited number of intermediaries. The organisations use this type of distribution for products that have special features and purchased very rarely, require service or information to fit them to buyers' needs and more expensive. If you want to buy a Skoda Octavia car or Christian Dior perfume, you will find at much selected store that could be 1 or 2 outlets in a big metro city. It is also used when producer wants to maintain control over the service level and service outputs offered by the resellers. Often it involves exclusive dealing arrangement, in which the resellers agree not to carry competing brands.

The choice among the alternatives will depend to a large extent on the nature of the market offering, the target segment and the product positioning. Lancaster and Massingham suggested that the some of the factors that might persuade a company to prefer a more exclusive form of distribution include:

- Where the customer needs or expects specialist advice, facilities and service
- Where the manufacturer and/or distributor would gain from the enhanced image associated with selective or exclusive distribution
- Where potential sales volume would not warrant more intensive distribution
- Where the manufacturer wishes to exercise more control over channel members' marketing activities
- Where more intensive distribution might result in conflicts between channel members

Cravens provided a summary of channel choice decisions as shown below.



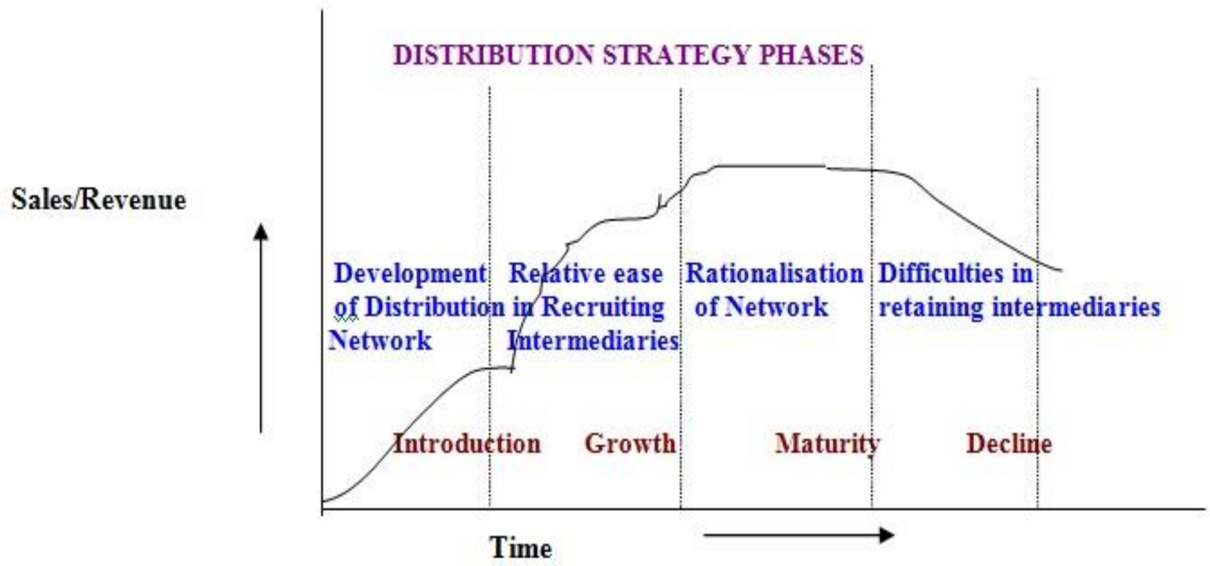
Linking Channel Design to Product Characteristics

Different products require different channel systems. The firm should analyse the characteristics of the product and choose the channel system that matches the product best. Consumer and industrial goods, for example, need different channels. And within the category of consumer goods, different sub-categories such as convenience goods, shopping goods and specialty goods may need different channel systems.

But, these strategies are not of permanent in nature. The channel decisions keep on changing with the change in product life cycle and customers' attitudes and affordability.

Product Life Cycle

The influence of PLC model on distribution is shown below:



As can be seen form the above figure, for the *introduction* phase for a manufacturer's brand, it is vital to secure an effective distribution network by the time that the product is launched. Where the brand is joining an organisation's existing portfolio of branded products this should not pose many problems, as the existing channels are likely to be suitable for the new product. However, wholesalers and retailers will expect incentives to stock a new brand in the form of discounted prices and merchandising support.

Growth is likely to see greater willingness on the part of stockists to take the brand. Demand will at this stage be growing, and intermediaries will want to be able to satisfy this.

At *maturity*, however, both the retailer and manufacturer of a brand may review their attitudes. Retailers may want to rationalise the number of competing brands in a product group to concentrate only on the best sellers, while manufacturers may want to concentrate distribution through only the most cost-effective outlets, thus eliminating those, which take only small orders. Finally, during the *decline* phase, manufacturers face pressure from retailers to offer even bigger discounts just to keep the brand on the shelves. It is particularly important to keep these channels open if a relaunch of the brand is imminent, rather than having to re-activate them in the future.

As thumb rule, the companies while entering into a new market may select exclusive distribution and as the demand increases they may shift to selective and then intensive distribution.

Industrial and Consumer Products Need Different Channels

Industrial and consumer products usually need different channels as they differ from each other in several vital respects. Industrial products need extensive pre-sale service (installation and commissioning service) and post-sale service (maintenance service). Consumer products on the contrary, are mass products. Non-technical and least most of them are of a low unit value; they are regularly consumed and replaced; and require nil or limited after-sale service. It is in view of these differences that the two can need different channel systems.

Among industrial products, only some are amenable for selling through channels. The firm should check whether its items are appropriate for selling through channels / distributors. And, if the answer is 'yes', it must find out which type of distributors will be appropriate for the items under consideration.

Industrial Products: Amenability for Marketing through Channels

- Only some industrial products lend for selling through channels.
- The product must have a sizeable customer base.
- It must be a reasonably standard item; not a totally custom-made item.
- It must be a stackable item.
- The unit value of the product should not be too high.
- In any case, industrial products need specialist distributors.

Industrial products as a general rule require specialist distributors. Entrusting the products with the traditional consumer product distributors does not bring in the best results. Different industrial products need different types of distributors. For example, some industrial products have to be demonstrated to the customers. Here, specialist distributors with the required demonstration facility will be more suitable. Some industrial products are hazardous from the point of view of distribution. Petroleum products, explosives and certain industrial chemicals are examples of this category these products need specialized distributors, who command specialized transportation and storage facilities. Similar is the case of products that require extensive servicing. They need specialist distributors, who command the required service facilities.

Even within Consumer Products, Channel Requirements of Different Products may vary. We come across three distinct categories of products within consumer goods viz.,

(i) Convenience goods

(ii) Shopping goods

(iii) Speciality goods.

We have seen that the different categories of goods require different channel systems, since buying behaviour and buying habits differ, depending on the category Convenience goods require intensive market coverage and, therefore, need a comprehensive and high penetration channel arrangement. Shopping goods and speciality goods need lesser intensity of coverage, compared to convenience goods. Often, in these cases, the number of tiers in the channel can be less than those for convenience goods. The number of outlets too can be far lesser. In the matter of location of the outlets too, the requirements will be different in respect of convenience goods on the one hand, and for shopping and specialty goods, on the other. Obviously, there is a need for product-channel matching.

Evaluating channel alternatives

After identifying various channel alternatives, they need to be evaluated against economic, control and adaptive criteria.

- Economic: The companies have to decide the cost factors attached with every channel. Some channels sell more involving more cost or there could be some channel that require less cost, but sell very less. Hence the companies while evaluating channels must consider performance-cost combination of each channel with an objective of optimising the operations from economic perspective.

- Control: The issue of control over the marketing channel is a delicate issue. The companies should consider only those channels on which they could have proper control in terms of sales procedure, payment, promotion etc. If not controlled, the channels may push other competitive products into the market or may not be willing to take participation in trade promotions or may not pay back in proper time thus making the concerned company vulnerable and malfunctioning.
- Adaptive: In the wake of constantly changing marketplace, the company as well as its channel members should be quite adaptable to meet the change in demand at the marketplace. The companies must only look for those channels that have intention and capability to take innovative measure to satisfy their customers in order to survive in the business.

Evaluation of the Distribution Environment

While selecting the channel design, the firm should also take into account the distribution environment obtaining in the country/territory. It should evaluate the vital features of the distribution environment and ensure that the proposed channel design is compatible with them. Distribution environment in the broader sense includes the trade related legal environment as well. A mention about the legal environment relating to marketing and trade matters has been made in the chapter on The Marketing Environment. The legal implications of channel design must be carefully examined before taking a final decision.

Evaluation of Competitor's Channel Designs

The firm should also study the competitor's channel patterns before deciding its channel design. While the firm may not necessarily follow the competitors in channel design, it should analyse the plus and minus of the channel patterns adopted by each of its major competitors. Quite a number of firms do settle down for a 'follow the leader' policy in channel design. They find it an easy route.

But such an approach may deprive them of the chance to score an edge over competition through the channel strategy.

Matching the Channel Design to Company Resources

Choice of channel is also governed by the resources available with the organisation.

***Firms with limited resources settle for conventional channels**:* Firms with limited resources and small volume of business will normally find it difficult and uneconomical to opt for own channels. For such firms, establishing branch showrooms/depots/retail outlets of their own will result in a high unit cost of distribution, which they cannot afford. They are better off by depending on conventional channels. In fact, they are usually content with a small network of conventional intermediaries.

***Firms with larger resources have more options**:* Firms with larger resources and larger marketing operations can go in for varied distribution channels. In fact, in India, in several businesses, firms, which are strong in resources, usually operate two parallel channels, one reaching out to the customer through company depots and showrooms, and the other through conventional intermediaries. The textile business is a good example of this phenomenon. Firms like Reliance Industries, Bombay Dyeing, DCM and Mafatlals, have all gone in for such a two-pronged channel design. In some cases, however, even large firms prefer a distribution arrangement wherein they will not be required to pump in much of their resources. They are content with entrusting their distribution job to some distribution houses, appointing them either as the sole-selling agent or as marketers. Many manufacturers of pharmaceuticals, machine tools, agricultural equipment, electric motors and household appliances have adopted this route.

Selecting channel members

Once companies have identified and evaluated all the channel alternatives, the final task in channel-design process is to select the channel for their distribution operations. The decision of selecting the final channels should justify why these channels are better than others. The factors like market reputation, cooperativeness, sincerity, professionalism, aspiration for growth and profit, infrastructure and experience help the companies to take the final decision on channel recruitment. Wilson mentioned economic, control and adaptive criteria and Cravens added with this the 3 criteria of end-user considerations, product characteristics and manufacturer's capability and resources.