Channel-Management Decisions

Developing the channel design, recruiting intermediaries and inducting them into company are not everyday tasks in channel management. It is the administration and management of the distribution network that constitutes the everyday task here. After a company has finally selected a channel, the next task is how to manage it to meet the ultimate business objectives of the firm. We shall examine task in detail.

Component Tasks in Managing the Intermediaries

Determining the Trade Relations Mix

Evidently, developing the trade relation mix is the first task in distribution management. The trade relations mix or relations between a firm (principal) and its members revolve largely around the following four factors:

- Territory of operation
- Trade margin
- Functions that the channel members have to perform
- Functions that the firm has to perform

Territory of Operation

The firm must settle the issue of territory in a fair manner. Territory has significance at wholesale as well as retail levels. Different businesses have different requirements and different practices in this regard. FMCG businesses, for example, supply their products to practically all retail outlets; they do not assign any territory as such to any retailer; they assign territories only to distributors, redistribution stockists, and C&F agents. Durables marketers on the contrary, operate through a limited number of dealers in each town. Usually in these lines, territories are assigned to the dealers; even where territories are not exclusively assigned, an understanding is often worked out.

In some cases, manufacturers supply their products directly to certain specialised channels select consumers bypassing the appointed wholesale functionaries in the territory; Such buyers usually prefer, as a matter of policy, to deal with the principal rather than the wholesaler of the area. The wholesaler of the area often expects some compensation for such sales that take place in his territory. The manufacturers sometimes cover the wholesalers with an overriding commission for such sales. At other times, they do not provide any compensation whatsoever. The important point is that the firm must have settled in advance the policy in this regard with their wholesalers. The agreement between the firm and the wholesaler must specify whether and to what extent the wholesaler will be covered on such sales.

Trade Margin

Trade margin is the first element in trade relation mix. Channel member invariably looks for wholesome, juicy margin. The principals invariably try to peg it as modest as possible. The point to be noted here is that the margin must be sufficient to enable the dealer to gain a reasonable return on his investment.

Present-day dealers as a rule expect larger margin: In the earlier days, dealers managed to operate their outlets with modest trade margins. First, their investment in infrastructure was relatively low and they were able to make a profit even with a modest margin. Second, their expectation of profit was also relatively low. In recent years, the position has been changing rapidly. First, the new generation dealers adopt a more contemporary approach to retailing. Accordingly, their investment in the business infrastructure is much larger. They go in for attractive shops/showrooms; they periodically renovate and redecorate the premises; they also employ skilled and better-trained salesmen. All this naturally pushes up their investment in infrastructure and their overheads. Running costs too have been going up. Added to this, the expectation of the new generation dealers in the matter of profit is also considerably higher compared to the earlier day dealers.

Paradigm shift from 'gross margin' to 'retained earning': Thus, in the contemporary scene, in most cases, the manufacturers have to willy-nilly settle for a higher outflow towards dealer margin. It also becomes necessary for them to accept a paradigm shift in this matter-from 'gross margin' to 'retained earning'. They are required to hike the dealer margin to a level that would fetch the dealer a reasonable 'retained earning' after meeting all his normal expenses. They are also required to collaborate with their dealers and help them achieve a larger turnover and greater retailing productivity, so that at a given level of trade margin, their retained earning is higher.

In the matter of margins, the way it is structured and allocated among the different tiers/levels in the channel is as important as the total quantum. There are several instances where firms have suffered in their marketing endeavour on account of defective structuring and improper allocation of the margin among the different levels of the channel.

Real Life Case Scenario

Hawkins Pressure Cookers

Till the 1970s, Prestige pressure cooker, manufactured by the TTK group, was the leader in the Indian pressure cookers market, outselling Hawkins. Prestige had a strong distribution network. Hawkins had in its favour a good product design. In spite of its superior product design, Hawkins' sales were much lower than that of Prestige, largely as a result of its distribution weakness. The actual problem was that the retailers were getting only a small share of the total trade margin, while the sole distributor and the regional distributors were allowed to keep a large portion of the margin for themselves.

In the 1970s, Hawkins overtook Prestige and became the market leader. It attained a market share of 30 % as against Prestige's 21% and United's 10.5 %. It was by streamlining the distribution and recasting the margin structure that Hawkins achieved the feat. Till the 1970s, Hawkins was using Kellick-Nixon as the sole distributor for the product. It was paying Kellick-Nixon, 50 % of the list price as distribution margin. But, the latter was passing on just 17 % to the distributors, retaining 33 % for itself. The distributors in turn were passing on a mere 7 % to the retailers.

The actual costs to the sole distributor, Killick-Nixon, and the distributors amounted to just 2 to3 %. Yet, they were keeping a very high share of the margin for themselves, 33 % and 10 %, respectively. Against this, the retailers, who had to incur all major expenses on the distribution of the product—storage cost, cost of inventories, and cost of shop/personal—received only 7 %.

In the revamping exercise, as a first step, Hawkins dispensed with the sole-selling arrangement with Killick-Nixon and took the distribution responsibility into its own hands. Then, it recast the margin structure thoroughly.

It set up four regional distributors (subsequently, the number went up to 15) and increased their margins to 20 %. They were made to pass on 14 % to the retailers. The doubling of the margin to the retailers played a substantial role in the increased sales and market share of Hawkins. The company also introduced several trade promotion schemes to enlist the enthusiastic participation of the retailers in promoting the brand.

Functions which channel has to Perform

Distribution channels are notable because they represent the first significant manifestation of a market framework. A distribution channel moves goods and services from producers to consumers. A distribution system comprises one or more distribution channels. They are the primary delivery paths and overcome major time, place and possession vacuums that separate goods and services.

The key functions performed by the members of the marketing channel are:

- **Information:** Channels provide market intelligence and feedback to the principal. In the nature of things, channels are in a good position to perform this task, since they are in constant and direct contact with the customers. They feel the pulse of the market all the time. Assimilating and disseminating marketing research and intelligence information about factors and forces in the marketing environment, needed for planning and aiding exchange is thus one of the functions of the marketing channels.
- **Promotion**: If an offer is to be made, the initiation and persuasive communications have to be developed.
- **Contact:** Developing contacts with existing and potential buyers from the available database.

- **Standardizing transactions***:* Intermediaries deliver products or services in consistent form, based on the needs of the buyer and the supply of the seller.
- **Regrouping. activities***:* Intermediaries are charged with sorting out, accumulating, allocating, and assorting products and services
- **Matching:** This is an important function because the order has to be made according to buyers' specifications. This also includes precautionary measures like grading, sampling and packaging.
- **Negotiation:** In many cases, the channels also help implement the price mechanism. They conduct price negotiations with buyers on behalf of the principals and assist in arriving at the right price- the price that is acceptable to the maker as well as the user. In other words, a win-win situation for both buyer and the seller where they agree on a mutually set price and other terms of the offer. This is done in order to transfer the ownership or possession. This is vital for the consummation of the marketing process. The manufacturer would find it difficult to complete this step without the help of the channels.
- **Physical distribution:** Channels also look after a part of the physical distribution functions like transportation, handling, warehousing, sub-distribution, order processing and inventory management. Since the costs of physical distribution can amount to more than a quarter of sales price at manufacturing level and the necessary assets can amount to as much as a third of the corporate assets, it is important for management to keep these costs down. It is possible to keep visible costs, such as warehousing, inventory and transport, down when the logistics functions are integrated. The invisible costs are due to customer dissatisfaction caused by late deliveries, lost sales/orders, etc. Control of these costs, both visible and hidden, is very difficult owing to the effect of any changes on customer service levels. Improvement of the latter can increase costs and a decrease in costs may mean a drop in the quality of the service. Physical distribution management provides guidelines for keeping a balance between cost and service levels
- **Building the Brand:** Dealers always want their principals to provide them a winning brand. Discriminating dealers give far more emphasis to the firm's performance on the brand front rather than the trade margin offered by the firm. They hesitate to take dealership

of weak brands even if they offer very attractive margins. And, they are happy to deal strong brands even if the margins offered are low.

- **Build the brand and keep it a winner:** They overwhelmingly vote for products/brands that move from the shelf without any need for pushing. Likewise, they vote for products and brands that make their customers come back to their shops with enthusiasm. They also prefer products/brands that provide them volume margins rather than value margins. Dealers have to put in a lot of their time. Effort, shelf space and money on the various products that they deal in, and they certainly do not want to get stuck with a weak brand. In particular, when a company offers a new brand the dealers want to be sure that the company would continue with the brand and build it well.
- **Financing:** Acquiring and using funds to cover the costs of the channel work is another major function. Channels also share the financial burden of the manufacturer by financing the goods flowing through the marketing pipeline. Often, they pay cash and lift the products; in the process, the manufacturer gets his money long before the products reach the ultimate users. In some cases, the channels provide substantive deposits to the principals. In several cases, the channels also extend credit to the subordinate levels in the channel and to the consumers. This also relieves the principals' financial strain to an extent. More than everything else, the channels place the products close to potential consumers and thereby enhance the chance of its sale. For example, the mission of Maruti Finance, a wholly owned subsidiary of Maruti Udyog a car maker, is to finance not only ultimate consumers of its automobiles but also the inventories held by dealers.
- **Risk taking:** Risk, which is an important element of business, has to be taken into consideration for carrying out the channel work.
- **Distribution Efficiency:** The channels bring together the manufacturer and the user in an economic manner and thereby provide distribution efficiency to the manufacturer. This is done by :

  Minimizing the number of contacts needed for reaching consumers: It will be impractical for a manufacturing firm to sell its entire production directly to the consumers. Resource constraint is the first hurdle in this regard. Even assuming that the required resources can be found, the question arises whether it will be advantageous for the firm to sell its products directly. Marketing channels analysis shows that in most cases, using external marketing channels/intermediaries is more advantageous to the firm than performing the distribution function all by itself. When channels are dispensed with, the number of contacts a manufacturer will have to establish for reaching out to the consumers are far too many; Channels minimize the number of contacts.

***Breaking the bulk and catering to tiny requirements*:** Channels break the bulk and meet the small-size needs of individual consumers.

***Supplying products in suitable assortments*:** Channels also combine products and components manufactured by different firms and offer them in assortments that are convenient to users. The users normally need an assortment of items. They will shop at only those outlets, which supply such assortments. But, a manufacturer cannot meet the need for such assortments, since it will not be feasible for him to take up distribution of other products required by the customers. The channels thus render the vital service of assembling the products of different manufacturers and offering them to customers in suitable assortments. In other words, the channels help in "matching segments of supply with segments of demand".

- **Provide Salesmanship:** Marketing channels also provide salesmanship. In particular, they help in introducing and establishing new products in the market. In many cases, buyers go by the recommendations of the dealers. The dealers establish the products in the market through their persuasive selling and person-to-person communication. Thus dealers can win the confidence of many customers and thus increase sales. They also provide pre-sale and after-sale service to the buyers.

- **Assist in Merchandising:** Merchandising is another important function performed by marketing channels. Through merchandising, they help reinforce the awareness about the product among customers. When a customer visits a retail shop, his attention can be allured by an attractive display of the product brand increasing his awareness and interest. Merchandising, especially display complements the selling efforts of the company and acts as a silent salesman at the retail outlet.

- **Act as Change Agents and Generate Demand:** In certain cases, the marketing task involves diffusion of some innovation among consumers. In such cases, the channels go much beyond the conventional functions of distribution aid act as 'change agents' among consumers and generate demand for the product.

- **Take Care of the Flows Involved in Distribution**: The distribution process can be viewed as a series of flows. The physical flow of products, the title/ownership flow, risk flow, the negotiation flow, the financing/payment flow, the information flow and promotion flow. Marketing channels handle and take care of all these flows.

The foregoing elaboration not only explain the importance of marketing channels, but also clarify the fact that the channels acquire their importance by virtue of the functions they perform. Despite these efficiencies, the press, consumers, public officials, and other marketers freely criticize intermediaries, especially wholesalers.

a. Critics accuse wholesalers of being inefficient and parasitic.

b. Buyers often wish to make the distribution channel as short as possible, assuming that the fewer the intermediaries, the lower the price will be.

c. Because suggestions to eliminate them come from both ends of the marketing channel, wholesalers must be careful to perform only those marketing activities that are truly desired.

Critics who suggest that eliminating wholesalers would lower customer prices do not recognize that this would not eliminate the need for services that wholesalers provide. Although wholesalers can be eliminated, the functions they perform cannot.