

part 1

Marketing Channel Systems

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chapter

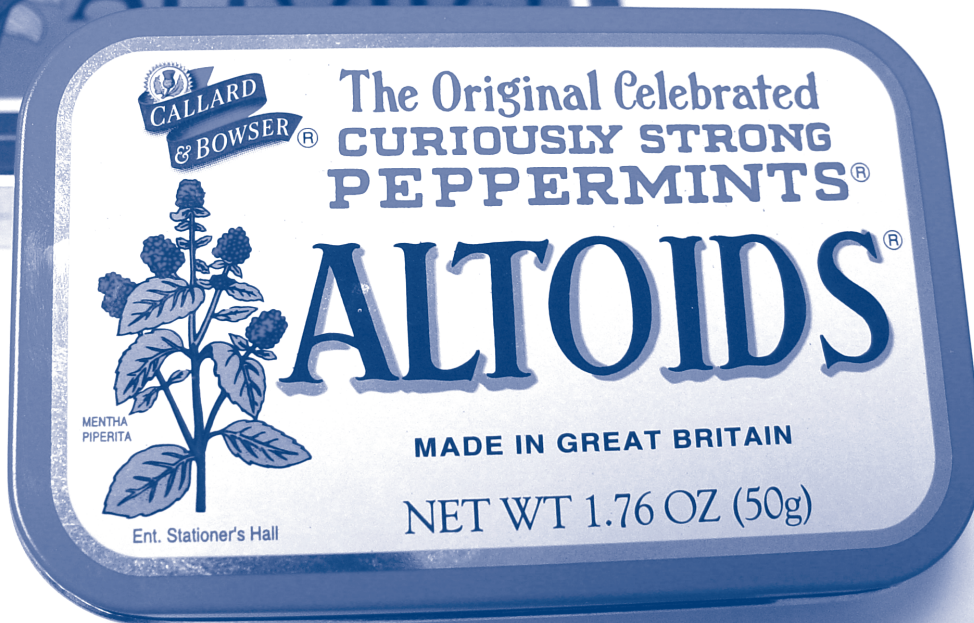
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Marketing Channel Concepts

Learning Objectives:

After reading this chapter you should:

- Be aware of the growing importance of marketing channels in the larger field of marketing.
- Understand the definition of the marketing channel from a managerial perspective.
- See how marketing channels relate to the other strategic variables in the marketing mix.
- Know the flows in marketing channels and how they relate to channel management.
- Understand the principles of specialization and division of labor as well as contactual efficiency in marketing channels.
- Be familiar with the concepts of channel structure and ancillary structure and recognize the difference between them.



FOCUS ON CHANNELS

The Right Marketing Channels Turned a Mint into a Mint

How do you go from an obscure product with annual sales under \$10 million to an internationally recognized brand with mass appeal and sales over \$100 million in less than a decade? Altoids did it with some smart marketing channel strategy.

It seems like everybody now recognizes the name “Altoids” as the maker of those extra-strong hard candy mints packaged in little tin boxes that seem to be sold everywhere at \$2 or more a pop. But it wasn’t too long ago that the “curiously strong” taste of Altoids mints was known mainly to a small cult following in England and to a few aficionados in the U.S. who prowled gourmet shops. All this changed when the Kraft Foods division of Philip Morris Companies, the producer of Altoids, believed that its mints could enjoy a much wider appeal. For this to happen, Altoids would have to be repositioned from an obscure novelty item to a mainstream mass-market product. Yet Altoids’ cachet and premium price would still have to be maintained. So, a marketing strategy based on heavy advertising with big price reductions,

a common strategy for penetrating mass markets, was out of the question. Instead Kraft decided to use a mass distribution strategy by making Altoids available in supermarkets, drug chains, and mass merchandisers all over the U.S. Kraft reasoned that having Altoids readily available wherever consumers shopped would have great appeal because of the convenience factor, and the giant retail chains would welcome the additional revenue and high margins provided by a product that could be sold as an impulse item at checkout counters, while taking up very little shelf space.

The tenfold growth in sales of Altoids during the 1990s is testimony to how effectively Kraft’s marketing channel strategy worked out. Indeed, while making this curious mint conveniently available to millions of consumers by placing it in the marketing channels where they shopped every day, Kraft and the retail chains reaped a mint in sales and profits.

Source: Based on Cathleen Egan, “Altoids Mint Success Opens Door for Candy Market’s Niche Players,” Wall Street Journal (August 20, 2001): B8.

The Altoids example illustrates the essence of what marketing channels are all about—making products and services conveniently available to customers when, where, and how they want them. From Amazon.com, which sells books and other consumer products online,¹ to ZooDoo, a producer of fertilizer made of manure collected from zoo animals and sold to organic gardeners, it is through marketing channels that the vast array of customer demand is satisfied.

These marketing channels and the people who participate in them comprise complex and dynamic systems. But much of what they do is not visible to final customers. Customers see only the end result of a host of strategies, plans, and actions that create new types of stores, distribution centers, services, and technologies that determine the structure and operation of marketing channels. Marketing channels in turn affect the lives of hundreds of millions of customers who rely on them to make the myriad of products and services from around the globe so conveniently available.

In this text we go “behind the scenes” and take an in-depth look at marketing channels. We examine the nature of marketing channels, their importance in marketing, and how they evolve, develop, and change. We will focus especially on the role of strategy in marketing channels, as well as how they are designed, managed, and evaluated. Although, as mentioned earlier, much of the activity in marketing channels takes place behind the scenes, as we proceed through the text and peer into this background, a challenging and fascinating part of marketing will emerge.

Growing Importance of Marketing Channels

As a strategic marketing tool, marketing channels had, for many years, taken something of a “back seat” to the other three strategic areas of the marketing mix: product, price, and promotion. Many firms viewed marketing channel strategy as somewhat of a “leftover” after the more “important” product, price, and promotional strategies had been considered.

But this neglect of marketing channels has changed—in many cases to a keen interest in the area.² Why has this happened? At least four developments underlie this shift in emphasis:

1. Explosion of information technology and E-commerce
2. Greater difficulty of gaining a sustainable competitive advantage
3. Growing power of distributors, especially retailers in marketing channels
4. The need to reduce distribution costs

Explosion of Information Technology and E-Commerce

By the late 1900s, Internet-based electronic commerce (E-commerce) had become the most talked about business phenomenon of the twentieth century. Nothing short of a revolution was predicted where “old economy,” “land-based,” “legacy,” or “bricks and mortar” businesses were supposed to succumb to the “new paradigm” of the pure-play dot-com start-ups that were creating a “new economy” based on the technology of E-commerce. In fact, a new piece of jargon called **disintermediation** was bandied about as a shorthand for the metamorphosis that was to occur. Hundreds of thousands of producers would be connected directly with millions of consumers on a global scale without the help of middlemen, who would be disintermediated from marketing channels.

1. Robert D. Hof and Heather Green, “How Amazon Cleared That Hurdle,” *Business Week* (February 4, 2002): 61–65.

2. Gary L. Frazier, “Organizing and Managing Channels of Distribution,” *Journal of the Academy of Marketing Science* (Spring 1999): 226–240; James A. Narus and James C. Anderson, “Rethinking Distribution,” *Harvard Business Review* (July–August 1996): 112–120.

As we now know, this E-commerce revolution did not occur as predicted.³ The disintermediation transformation did not take place at anywhere near the predicted level. Indeed, **reintermediation**—involving new types of middlemen called infomediaries, such as Yahoo!, eBay, and Autobytel along with cyber retailers such as Amazon.com—emerged to connect buyers and sellers via the Internet.⁴ Moreover, “old-fashioned” bricks and mortar retailers that added online capabilities to their traditional channels of distribution appear to have gained the upper hand over the so-called pure-play dot-coms. Indeed, most of the super-hyped dot-coms are now bankrupt, and hundreds of billions of dollars in market capitalization have disappeared. In both business-to-consumer (B2C) and business-to-business (B2B) markets,⁵ E-commerce is looking more like an evolution than a revolution.

Yet the fact that the E-commerce revolution did not “change everything” in the couple of years before the bubble burst does not mean that it will not be a profound force in shaping the structure and strategy of marketing channels in the future. Indeed, it already has had tremendous effects.⁶ Online sales have become an established distribution channel in both B2C and B2B markets, accounting for hundreds of billions of dollars in sales with rapid growth ahead. But perhaps more important, E-commerce is merging or converging with conventional channels across virtually all sectors of the economy, not only in the U.S. but around the world. Thus, marketing channel strategy, design, and management must now deal with E-commerce technology as an integral part of marketing channels and distribution systems.

Difficulty in Gaining Sustainable Competitive Advantage

A **sustainable competitive advantage** is a competitive edge that cannot be quickly or easily copied by competitors. In recent years, it has become far more difficult for companies to attain such an advantage through product, price, and promotion strategies.

With regard to **product strategy**, rapid technology transfer from one company to another and global competition have made it much easier for competitors to achieve parity in product design, features, and quality. From automobiles, computers, consumer electronics, industrial machinery, apparel, grocery products, cosmetics, sporting goods, office equipment, and a host of other products, the ability of any given company to compete over the long run by relying on its products being better or different from the other guy’s has become exceedingly difficult to sustain.⁷

Gaining a sustainable competitive advantage via **pricing strategy** in today’s global economy is even less feasible than through product strategy. The ability of more and more firms to operate production facilities all over the world has created fierce price competition in many different product categories and, to an increasing extent, in services as well. Consequently, a company whose strategy emphasizes lower prices than competitors’ is not likely to hold on to that advantage for very long. Another company, domestic or foreign, manufacturing the same products somewhere around the globe is virtually certain to match or undercut the price.

The third area of the marketing mix, **promotion**, has also become a precarious strategy for gaining a sustainable competitive advantage. The massive barrage of advertising and other forms of promotion to which consumers are exposed on a daily basis has created enormous clutter, which drastically reduces the impact of promotional messages. Hence, the effects of even the most clever and carefully crafted promotional messages are short-lived as literally thousands of messages knock each other out of the target audience’s mind. So, holding on to a

3. Bert Rosenbloom, “The Ten Deadly Myths of E-Commerce,” *Business Horizons* (March–April 2002): 61–66.

4. Jeff Bailey, “Web Sites Force Middlemen to Redefine Markets,” *Wall Street Journal* (June 11, 2002): B4.

5. Sean Donahue, “B-to-B Better Be Patient,” *Business 2.0* (December 26, 2000): 49.

6. See, for example: Wendy Zellner, “Online Travel Takes Wings,” *Business Week* (April 1, 2002): 77.

7. Donald V. Fites, “Make Your Dealers Your Partners,” *Harvard Business Review* (March–April 1996): 84–95.

competitive advantage gained through promotion has become all but impossible today in the face of such intense clutter.

After product, price, and promotional strategy, the fourth so-called “P” in the marketing mix, **place**, or marketing channel strategy, *does* offer greater potential for gaining a competitive advantage than the others because it is *more difficult for competitors to copy*. Consider the case of Edward Jones, the largest network of brokerage offices in the U.S., with some 8,357 locations and still growing.⁸ This St. Louis-based firm has built its business by providing excellent personal service face-to-face with its clients in the thousands of communities in which they live. The vast number of offices makes it easy for clients in almost any city in the U.S. as well as Canada and England to visit an office and get in-person advice and assistance from professional brokers. This people-intensive, service-oriented strategy offered at thousands of “bricks and mortar” brokerage offices may seem quaint in an era of high-tech online stock trading. But Edward Jones is appealing to a target market that seeks the kind of service that is not available from the tech-oriented brokerages such as E-trade or from giants such as Merrill Lynch. In fact, Merrill dropped personal service to small clients and instead directed them to call centers. This has created a stampede of a thousand clients per month from Merrill to Edward Jones.

In spite of Edward Jones’s high-cost office network, it has been more profitable than Merrill, Charles Schwab, and Morgan Stanley Dean Witter & Co. Edward Jones has built a channel structure and strategy aimed at the still-huge market segment that wants a physical location, along with personal service and advice, when it comes to financial matters. The infrastructure, organization, and people it took to create Edward Jones’s marketing channel for financial services obviously could not be quickly or easily copied by competitors.⁹

Growing Power of Distributors

Over the past two decades, economic clout has shifted from the producers of goods to the distributors of goods.¹⁰ This shift in economic power has been especially noticeable at the retail level of marketing channels, where giant mass merchandisers such as Wal-Mart and so-called category killers such as Home Depot, Office Max, Toys “R” Us, CompUSA, Sports Authority, and numerous others have become dominant players. These **power retailers** account for large shares of the commodity lines in which they deal and hence they control access to the marketplace.¹¹

From the manufacturer’s perspective, these powerful retailers play the role of “gatekeepers” into consumer markets. As gatekeepers, they act as buying agents for their customers rather than as selling agents for manufacturers. Most also operate on a low-margin/low-price format and have emerged as sophisticated marketers and fierce competitors that make tough demands on the manufacturers who supply them.¹² As a result of this development, the need

8. John A. Byrne, “Main Street Trumps Wall Street,” *Business Week* (June 10, 2002): 134–138.

9. For a related discussion see Robert A. Robicheaux and James E. Coleman, “The Structure of Marketing Channel Relationships,” *Journal of the Academy of Marketing Science* (Winter 1994): 38–51; Barton A. Weitz and Sandy D. Jap, “Relationship Marketing and Distribution Channels,” *Journal of the Academy of Marketing Science* (Fall 1995): 305–320.

10. Bert Rosenbloom and Diane Mollenkopf, “‘Dominant Buyers’: Are They Changing the Wholesaler’s Role in Marketing Channels?” *Journal of Marketing Channels* (Fall 1993): 73–90.

11. For a somewhat different and perhaps controversial perspective on this, see Chip E. Miller, John Reardon, and Denny E. McCorkle, “The Effects of Competition on Retail Structure: An Examination of Inratype, Intertype, and Inter-category Competition,” *Journal of Marketing* (October 1999): 107–120.

12. Christina Duff, “Big Stores’ Outlandish Demands Alienate Small Suppliers,” *Wall Street Journal* (October 27, 1995): B1, B5.

	Autos	Software	Gasoline	Fax Machines	Packaged Foods
Distribution	15%	25%	28%	30%	41%
Manufacturing	40	65	19	30	33
Raw Material and Components	45	10	53	40	26

Table 1.1
Distribution Costs Compared to Manufacturing, Raw Materials, and Components Costs as a Percentage of Final Product Price

Source: Christine B. Bucklin, Steven D. Defalco, John R. DeVincentis, and John P. Levis III, "Are You Tough Enough to Manage Your Channels?" *The McKinsey Quarterly* 1996, 106.

for producers and manufacturers to develop an effective marketing channel strategy for dealing with these powerful and dominant retailers has become stronger than ever.¹³

Need to Reduce Distribution Costs

Distribution costs often account for a significant percentage of the final price of products. In fact, sometimes distribution costs are higher than the manufacturing cost or the costs of raw materials and component parts. Table 1.1 shows some examples for several product categories.

Over the past decade, a massive effort by companies to drive down costs of manufacturing and internal operations has taken place. Programs such as restructuring, reengineering, and the flattening out of organizations have all been driven by this quest to reduce costs.

This massive effort to squeeze out costs is now being extended to the marketing channels that firms use to reach their customers. Thus, the "new frontier" for cost control in the twenty-first century will be marketing channels. But in order to reduce the costs of distribution while providing equal or superior product availability to customers, firms will need to focus much more attention on marketing channel structure and management than they have in the past.

The Marketing Channel Defined

The concept of the marketing channel can be confusing. Sometimes it is thought of as the route taken by a product as it moves from the producer to the consumer or other ultimate user. Some define it as the path taken by the title to goods as it moves through various agencies. Still others describe the marketing channel in terms of a loose coalition of business firms that have banded together for purposes of trade.

Much of the confusion probably stems from differing perspectives or viewpoints. The manufacturer, for example, may focus on the different intermediaries needed to get products to customers, so he might define the marketing channel in terms of the movement of the products through these various intermediaries. Intermediaries such as wholesalers or retailers who are expected to carry substantial inventories from various manufacturers and bear the risks associated with this function may view the flow of the title to the goods as the proper delineator of the marketing channel. Consumers may view the marketing channel as simply "a lot of middlemen" standing between them and the producer of the product. Finally, the researcher observing the marketing channel as it operates in the economic system may describe it in terms of its structural dimensions and efficiency of operation.¹⁴

13. Adam J. Fein and Sandy D. Jap, "Manage Consolidation in the Distribution Channel," *Sloan Management Review* (Fall 1999): 61–72; Christopher M. McDermott and Gina C. O'Connor, "Managing in the Age of the Mass Merchant," *Business Horizon* (November–December 1995): 64–70.

14. See Roger Dickinson and Bixby Cooper, "The Emergence of Cost-Based Strategies in Retailing," *Journal of Marketing Channels* (Fall 1992): 29–45.

Given these differing perspectives, it is not possible to have a single definition of the marketing channel. In this text, we take a managerial decision-making viewpoint of the marketing channel as seen mainly through the eyes of marketing management, primarily in producing and manufacturing firms. Thus, the marketing channel is viewed as one of the key marketing decision areas that marketing management must address. In this context, the **marketing channel** may be defined as:

The external contactual organization that management operates to achieve its distribution objectives.

Four terms in this definition should be especially noted: *external*, *contactual organization*, *operates*, and *distribution objectives*.

The term **external** means that the marketing channel exists *outside* the firm. In other words, it is not part of a firm's internal organizational structure. Management of the marketing channel therefore involves the use of **interorganizational management** (managing more than one firm) rather than **intraorganizational management**¹⁵ (managing one firm). It is very important to keep this point in mind because many of the special problems and peculiarities of managing the marketing channel discussed later in the text stem from this external (interorganizational) structure.¹⁶

The term **contactual organization** refers to those firms or parties who are involved in negotiatory functions as a product or service moves from the producer to its ultimate user. Negotiatory functions consist of buying, selling, and transferring title to products or services. Consequently, only those firms or parties who engage in these functions are members of the marketing channel.¹⁷ Other firms (usually referred to as *facilitating agencies*) such as transportation companies, public warehouses, banks, insurance companies, advertising agencies, and the like, which perform functions other than negotiatory, are excluded.¹⁸ This distinction is not a matter of academic hairsplitting. The channel management problems involved when dealing with firms or parties performing negotiatory functions are often fundamentally different from those encountered when dealing with agencies that do not perform these functions. This will be apparent at many points as we proceed through the text.

The third term, **operates**, suggests involvement by management in the affairs of the channel. This involvement may range from the initial development of channel structure all the way to day-to-day management of the channel. When management operates the external contactual organization, it has made a decision not to let this organization simply run by itself. This does *not* mean that management can have total or even substantial control of the channel. In many cases, as we shall see in subsequent chapters, this is not possible. On the other hand, by

15. An in-depth discussion of the interorganizational point of view can be found in William Evan, "Toward a Theory of Inter-Organizational Relations," in *Distribution Channels: Behavioral Dimensions*, ed. Louis W. Stern (New York: Houghton Mifflin, 1969), 73–89. See also R. L. Warren, "The Interorganizational Field as a Focus for Investigation," *Administrative Science Quarterly* 12 (December 1967): 396–419; and Gary L. Frazier, "Interorganizational Exchange Behavior in Marketing Channels: A Broadened Perspective," *Journal of Marketing* (Fall 1983): 68–78.

16. For a related discussion, see Daniel H. McQuiston, "A Conceptual Model for Building and Maintaining Relationships Between Manufacturers' Representatives and Their Principals," *Industrial Marketing Management* Vol. 30, 2001: 165–181.

17. This definition includes consumers or other final users as members of the marketing channel. See Kent L. Granzin, "The Consumption Unit as a Member of the Distribution Channel," in *Developments in Marketing Science*, Vol. XI, ed. Kenneth D. Bahn (Blacksburg, Va.: Academy of Marketing Science, 1988), 460–464.

18. This view is similar to that taken by Louis P. Bucklin, *Competition and Evolution in the Distributive Trades* (Englewood Cliffs, N.J.: Prentice-Hall, 1972), 9. For the original presentation of this concept, see Edmund D. McGarry, "The Contactual Function in Marketing," *Journal of Business* (April 1951): 96–113.

operating the channel, management is acting to avoid unwitting control of *its* actions by the channel.¹⁹

Finally, **distribution objectives**, the fourth key term in the definition, means that management has certain distribution goals in mind. The marketing channel exists as a means for reaching these. The structure and management of the marketing channel are thus in part a function of a firm's distribution objectives. As these objectives change, variations in the external contactual organization and the way management attempts to operate it can also be expected to change.

Use of the Term *Channel Manager*

Throughout this text we will generally be using the term **channel manager** to refer to anyone in a firm or organization who is involved in marketing channel decision making. In practice, few firms or organizations actually have a single designated executive position called channel manager.²⁰ However, as shown in Figure 1.1, some major American firms have executive positions whose duties are similar to those of the channel manager as defined here; at Compaq

Firm Name	Channel Management Job Title
American Cyanamid Co.	Business Development Manager
American Greeting Corp.	Team Marketing Manager
Bausch & Lomb Co.	Director, Trade Marketing
Borden, Inc.	Sales Coordinator
Compaq Computer Corp.	Director of Channel Management
Coca-Cola Co.	Director, Customer Business Development
Duracell	Trade Marketing Manager
Ergodyne Corp.	Market Team Adviser
Hewlett-Packard Co.	Planning Manager, Channel Marketing
Johnson & Johnson	Trade Marketing Director
Leaf Brands, Inc.	Vice President, Trade Marketing
Philip Morris, Inc.	Manager, Trade Relations
Polaroid Corp.	Trade Marketing Manager
Sandoz Pharmaceutical Corp.	Director of National Affairs
Sara Lee Corp.	Vice President, Customer Marketing
AOL Time Warner, Inc.	Sales Development Director

Figure 1.1
Channel Management
Job Titles Used by
Selected U.S. Firms

19. For related discussions on the need for channel management, see Gary L. Frazier and Raymond C. Rody, "The Use of Influence Strategies in Interfirm Relationships in Industrial Product Channels," *Journal of Marketing* (January 1991): 52–69; and Peter R. Dickson, "Distributor Portfolio Analysis and the Channel Dependence Matrix: New Techniques for Understanding and Managing the Channel," *Journal of Marketing* (Summer 1983): 34–44. See also N. Mohan Reddy and Michael P. Marvin, "Developing a Manufacturer–Distributor Information Partnership," *Industrial Marketing Management* (May 1986): 157–163; and John T. Mentzer, "Managing Channel Relations in the 21st Century," *Journal of Business Logistics* 14, no. 1: 27–42.

20. Donald W. Jackson, Jr., and Bruce J. Walker, "The Channels Manager: Marketing's Newest Aide?" *California Management Review* (Winter 1988): 52–58; and Bruce J. Walker, Janet E. Keith, and Donald W. Jackson, Jr., "The Channels Manager: Now, Soon or Never?" *Journal of the Academy of Marketing Science* (Summer 1985): 82–96.

Computer Corporation, which recently merged with Hewlett-Packard, the position of Director of Channel Management is perhaps the closest to the term *channel manager*. More often, depending on the type of firm or organization and its size, many different executives are involved in making channel decisions. For large consumer goods manufacturers, for example, the vice president of marketing, general marketing manager, product manager, brand manager, and sales manager might all be involved. In an industrial products company, the top sales executive, such as the vice president of sales or the general sales manager, might be the key channel decision maker. In some franchise organizations, common in the fast-food and service fields, a middle management executive called manager of franchisee relations sometimes plays an important role in channel decision making along with top sales and marketing executives of the franchisor. In smaller businesses across a wide spectrum of both consumer and industrial products companies, most channel decisions will be handled by the owner/manager.

Given that so many different types and levels of managers are involved in channel decision making and that few officially designated channel managers exist, we could have used a generic term such as *decision maker* or *marketer* when referring to an individual making channel decisions. However, we chose to use the term *channel manager* instead because we believe it provides a sense of focus for referring to the important role of channel decision making within the firm. So, regardless of an individual's actual job title, when that person is involved in making channel decisions, he or she is filling the role of channel manager even though such a position may not formally exist on the firm's organizational chart. In other words, anyone in the firm who is making channel decisions is, while involved in that activity, a channel manager.

Marketing Channels and Marketing Management Strategy

As alluded to in the discussion of Altoids at the beginning of this chapter, the well-known marketing mix strategy model provides the framework for viewing the marketing channel from a marketing management perspective.²¹ Recall that the marketing mix model portrays the marketing management process as a strategic blending of four controllable marketing variables (the marketing mix) to meet the demands of customers to which the firm wishes to appeal (the target markets) in light of internal and external uncontrollable variables. The basic marketing mix variables, often referred to as "the four Ps," are product, price, promotion, and distribution (place). The external uncontrollable variables are such major environmental forces as the economy, sociocultural patterns of buyer behavior, competition, government, and technology; the nonmarketing functions of the firm constitute internal uncontrollable variables. Figure 1.2 shows a typical portrayal of the marketing mix strategy model. The major tasks of marketing management are to seek out potential target markets and to develop appropriate and coordinated product, price, promotion, and distribution strategies to serve those markets in a competitive and dynamic environment.

Marketing **channel strategy**, one of the major strategic areas of marketing management, fits under the distribution (place) variable in the marketing mix. Management must develop and operate its marketing channels in such a way as to support and enhance the other strategic variables of the marketing mix in order to meet the demands of the firm's target markets.

Developments at Coors Brewing Company demonstrate the relationship of channel strategy to the other strategic variables in the marketing mix and the increasing importance of

21. For a review of the basic marketing mix strategy model, see Louis E. Boone and David Kurtz, *Contemporary Marketing*, 10th ed. (Fort Worth, Tex.: Dryden Press, 2000), Chapter 1.

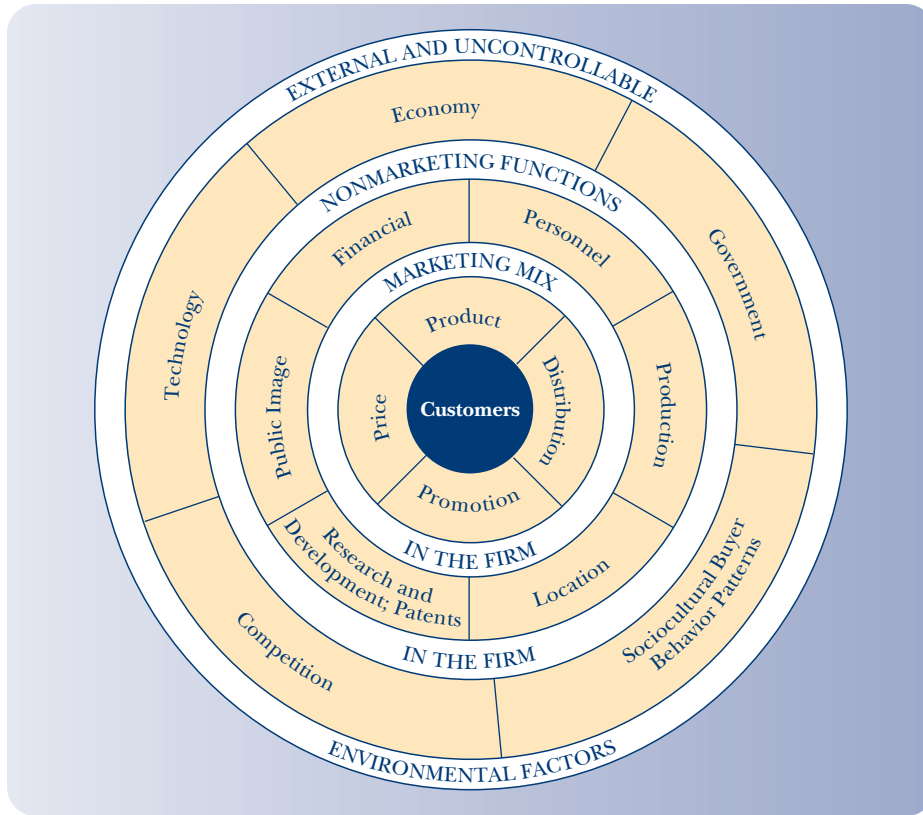


Figure 1.2
Marketing Mix Strategy Model

Source: Bert Rosenbloom, *Retail Marketing* (New York: Random House, 1981), 14.

the channel strategy variable.²² Coors Brewing Company is the nation's third-largest brewery—behind Anheuser-Busch Inc., best known for its Budweiser beer, and Miller Brewing Company. Coors has grown from essentially a regional brewery to full national distribution in all 50 states. But Coors, as a major player in the supercompetitive national beer market, is up against tremendous challenges. Beer consumption has slowed as more drinkers have switched to nonalcoholic beverages in the face of antidrinking campaigns and changing consumer preferences. This has made competition highly intense as the major breweries compete fiercely for market share. Meanwhile, microbreweries, which have emerged in greater numbers in recent years, and foreign brands have added another competitive dimension to the fray.

To deal with this very challenging competitive environment, Coors has carefully considered all of the strategic variables of the marketing mix. In the area of product strategy, the ability to gain and hold a competitive advantage is limited because of high rates of new product failure, short product life cycles, and the ability of competitors to quickly offer similar products. So, Coors decided not to bet the future of the company primarily on new product strategies.

Coors also concluded that pricing strategy as a basis for sustaining a competitive advantage presented great difficulties. In the beer industry, an emphasis on price strategy in recent years has led to intense price discounting and the so-called beer wars. Some 30–50 percent of all beer was sold at discount, and in some states the figure was as high as 60 percent.

22. Marj Charlier, "Coors Looks to Local Distributors for National Growth," *Wall Street Journal* (June 28, 1993): B4.

Such price wars erode profitability and provide a highly unstable basis for sustaining a competitive advantage.

Promotion strategy, mainly in the form of national brand advertising and point-of-sale promotion, is needed in the beer industry to build and maintain brand recognition. But Coors acknowledged that promotion is expensive and its effects short-lived as competitors seek to get their messages across in an increasingly cluttered market.

Given the limitations of product, price, and promotion strategies of the marketing mix, Coors concluded that its best hope for competing successfully in the slow-growth, highly competitive beer market was to emphasize channel strategy. Specifically, Coors would establish stronger relationships with its independent beer distributors than its chief competitors had.

The decision by Coors to focus on channel strategy as the key factor in achieving a sustainable competitive advantage in the tough beer market is not to suggest that product, price, and promotion strategies are not important. On the contrary, they are also critical, for obviously without good products that are attractively priced and well promoted, no firm can hope to be successful for very long. But from the standpoint of developing a competitive advantage that has *long-term viability*, channel strategy that focuses on building a strong relationship between the manufacturer and its channel members can be very effective. Why? Because such a relationship is not easily copied by competitors.²³ It cannot be duplicated quickly with technology, a brief cost advantage, or a clever idea, factors that are often at the root of competitive advantages based on product, price, and promotional strategies. Rather, a channel strategy that results in strong relationships among channel members—what in recent years have increasingly been referred to as *partnerships* or *strategic alliances*²⁴—is based on confidence, trust, and people power. In other words, the superior performance of a strong channel relationship is likely to result from the capabilities of the people in the organizations of the various channel members and their inclination to deliver superior performance aimed at achieving mutually beneficial goals.

As the number three player in the super-competitive beer market, Coors' emphasis on building strong relationships with its independent beer distributors has been vital to its competitive viability against its larger rivals. Strong distributor support also helped Coors to increase its profits even during the recession that took place during the first year of the new millennium—quite an achievement given the cutthroat competitive tactics employed by the two bigger players to gain beer distributor shelf space.

Although the Coors decision to emphasize channel strategy took place in the beer industry, similar actions are being taken by many firms in a wide variety of industries, including automobiles, high-tech electronics, consumer packaged goods, apparel, industrial machinery and equipment,²⁵ and many others.

Channel Strategy versus Logistics Management

As pointed out earlier, channel strategy fits under the distribution variable of the marketing mix. Logistics management also fits under this variable—and the two components (channel

23. For a related discussion, see Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 1985).

24. Fites, "Make Your Dealers Your Partners"; Jan Heide and George John, "Alliances in Industrial Purchasing: The Determinants of Joint Action in Buyer-Supplier Relationships," *Journal of Marketing Research* (February 1990): 24–36; "Competing for the American Consumer: Partnering for Quick Response," *Coopers & Lybrand Made in America*, Special Report (1992); and Gabriella Stern, "Phar-Mor Forges Stronger Ties with Manufacturers," *Wall Street Journal* (March 8, 1993): B4.

25. Fites, "Make Your Dealers Your Partners."

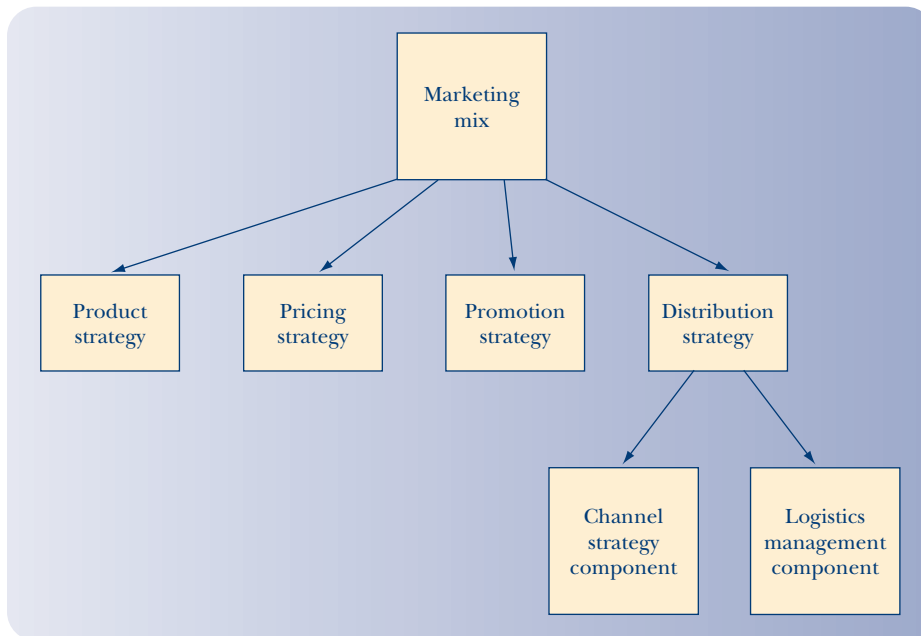


Figure 1.3
Marketing Mix Strategic
Variables with Distribu-
tion Variable Divided
into Channel and
Logistics Components

strategy and logistics management) together comprise the distribution variable of the marketing mix, as illustrated in Figure 1.3.

Channel strategy and logistics management are closely related, but channel strategy is a much broader and more basic component than is logistics management. Channel strategy is concerned with the *entire process* of setting up and operating the contactual organization that is responsible for meeting the firm's distribution objectives. Logistics management, on the other hand, is more narrowly focused on providing product availability at the appropriate times and places in the marketing channel. Usually, channel strategy must already be formulated *before* logistics management can even be considered.

An example from the case of Coors, discussed earlier, will help to clarify this point. Coors needed to plan channel strategy to deal with such issues as the identification and selection of appropriate beer distributors; how to motivate the distributors to emphasize Coors products; the various terms of the relationship, such as credit, payment procedures, and inventory levels; what kinds and levels of promotional support would be provided; and many other factors. Continued contact between Coors and the beer distributors would also be needed to make sure that the channel strategy was actually being carried out and to resolve the inevitable problems that arise in the course of distributing products. So, only *after* this channel strategy had been developed and implemented through channel management would logistical management enter the picture. Obviously, if the beer distributors could not be convinced to carry and aggressively sell Coors products, there would be little need for logistical management to provide for delivery of the right quantities of the product at the right times.

This is not to argue that logistics is not an important part of distribution strategy. On the contrary, effective logistics management is vital to the success of the firm's overall distribution strategy. Coors could hardly be successful if its products were not physically available when consumers wanted to buy them. But it does suggest that logistics management is *subsidiary* to the more basic and broader area of channel strategy and management.

Flows in Marketing Channels

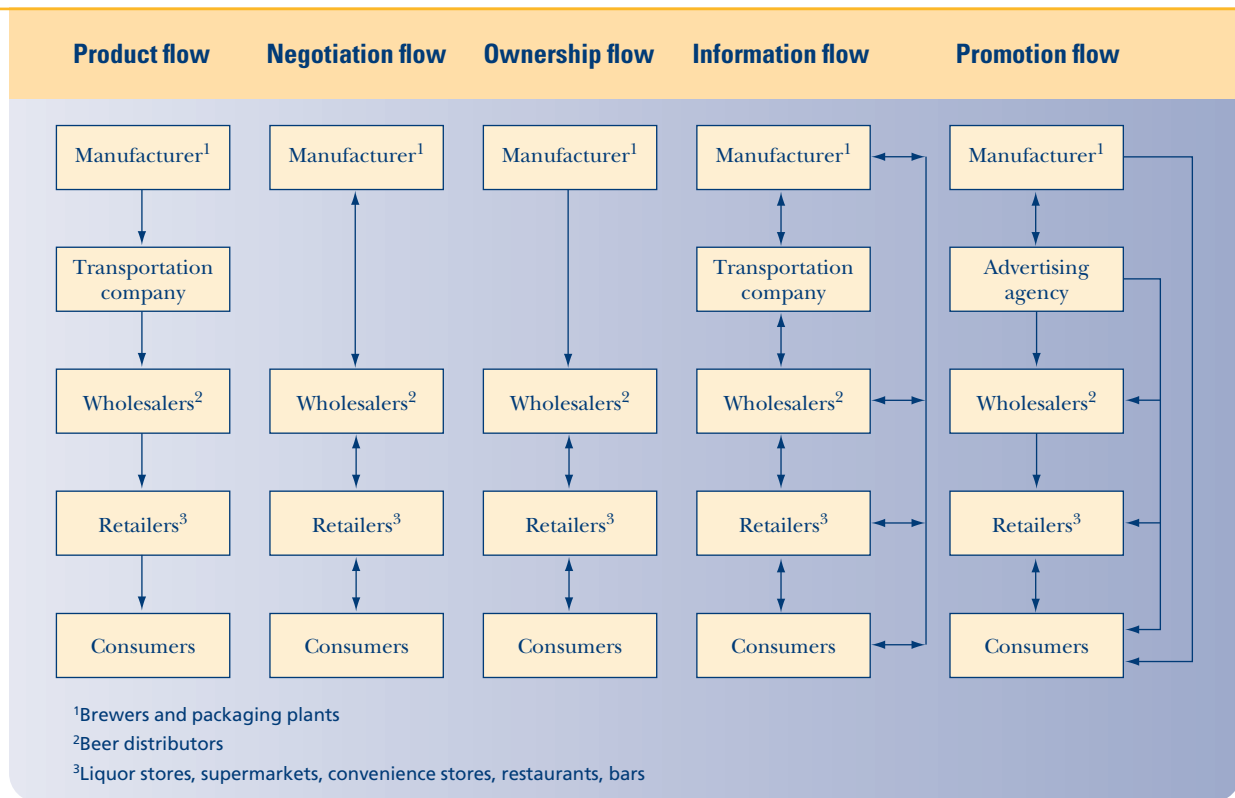
When a marketing channel has been developed, a series of flows emerges. These flows provide the links that tie channel members and other agencies together in the distribution of goods and services.²⁶ From the standpoints of channel strategy and management, the most important of these flows are:

1. Product flow
2. Negotiation flow
3. Ownership flow
4. Information flow
5. Promotion flow

These flows are illustrated for Coors beer in Figure 1.4.

The **product flow** refers to the actual physical movement of the product from the manufacturer (Coors) through all of the parties who take physical possession of the product, from its point of production to final consumers. In the case of Coors beer, the product comes from

Figure 1.4
Five Flows in the Marketing Channel for Coors Beer



26. The origin of the concept of flows in marketing channels is generally attributed to Roland S. Vaile, E.T. Grether, and Reavis Cox, *Marketing in the American Economy* (New York: Ronald Press, 1952), 113–129.

breweries and packaging plants in Colorado, Tennessee, and Virginia by way of company trucks or common carrier (transportation company) to beer distributors (wholesalers), who in turn ship the product (usually in their own trucks) to liquor stores, supermarkets, convenience stores, restaurants, and bars (retailers), where it is finally purchased by consumers.

The **negotiation flow** represents the interplay of the buying and selling functions associated with the transfer of title (right of ownership) to Coors products. Notice in the figure that the transportation firm is not included in this flow because it does not participate in the negotiatory functions. Notice also that the arrows flow in *both* directions, indicating that negotiations involve a mutual exchange between buyers and sellers at all levels of the channel.

The **ownership flow** shows the movement of the title to the product as it is passed along from the manufacturer to final consumers. Here again, the transportation firm is not included because it does not take title to the product nor is it actively involved in facilitating the product's transfer. It is only involved in the transportation of the physical product itself.

Turning now to the **information flow**, we see that the transportation firm has reappeared in this flow and that all of the arrows showing the flow of information from the manufacturer to consumers are two-directional. All parties participate in the exchange of information, and the flow can be either up or down. For example, Coors may obtain information from the transportation company about its shipping schedule and rates, and the transportation company may in turn seek information from Coors about when and in what quantities it plans to ship the product. The flow of information sometimes bypasses the transportation firm, as shown by the arrow leading from the manufacturer (at the right-hand side of the box) directly to the wholesalers, retailers, and consumers. This route of information flow occurs when the information sought does not concern the transportation company, such as details associated with the buying, selling, or promotion of Coors products. For example, if the manufacturer makes available to beer distributors a special reduced price on, say, Coors Zima Clear Brew or Coors Extra Gold beer, this information would be passed to the beer distributors directly and would not be of concern to the transportation firm.

Finally, the **promotion flow** refers to the flow of persuasive communication in the form of advertising, personal selling, sales promotion, and publicity. Here, a new component, the advertising agency, is included in the flow because the advertising agency is actively involved in providing and maintaining the promotion flow, especially the advertising element of promotion. The two-directional arrow connected by a line between the manufacturer and the advertising agency is meant to show that the manufacturer and advertising agency work together closely to develop promotional strategies. All other arrows show one-directional flow from the advertising agency or directly from the manufacturer to the other parties in the marketing channel.

The concept of channel flows provides another basis for distinguishing between channel strategy and logistics management. Earlier in this chapter we pointed out that channel strategy and management are broader components of distribution than logistics. In the context of the channel flows concept, this follows because channel strategy and management involve planning for and managing *all* of the flows, whereas logistics is concerned almost exclusively with the management of the product flow.

Further, the concept of channel flows provides a good basis for separating channel members from nonmembers. Recall that in our definition of the marketing channel, only those parties who were engaged in the negotiatory functions of buying, selling, and transferring title were considered to be members of the contactual organization (the marketing channel). From the standpoint of channel flows, then, only those parties who participate in the negotiation or ownership flows would be members of the marketing channel.

From a management standpoint, the concept of channel flows provides a useful framework for understanding the scope and complexity of channel management. By thinking in terms of the five flows, it becomes obvious that channel management involves much more

than merely managing the physical product flow through the channel. The other flows (of negotiation, ownership, information, and promotion) must also be managed and coordinated effectively to achieve the firm's distribution objectives.²⁷ Indeed, much of the material in this text is concerned with channel management activities that involve these channel flows. Dealing with environmental changes and the behavioral dimensions of channels (topics treated in Chapters 3 and 4) certainly involves the information flow. Formulating channel strategies, designing the channel, and selecting the channel members (the topics of Chapters 5, 6, and 7) are very much concerned with the negotiation, ownership, and information flows as well as the product flow. Motivating channel members (discussed in Chapter 9) is dependent on effective management of the information and promotion flows. Chapters 10, 11, 12, and 13 deal with the interfaces between channel management and management of the other variables in the marketing mix that require management and coordination of all of the flows. Finally, the evaluation of channel member performance (discussed in Chapter 14) is dependent almost entirely on effective management of the information flow.

From the perspective of channel management, the concept of flows in marketing channels helps to convey the dynamic nature of marketing channels. The word *flow* suggests movement or a fluid state, and indeed this is the nature of channels of distribution. Changes, both obvious and subtle, always seem to be occurring. New forms of distribution emerge, different types of intermediaries appear in the channel while others drop out, unusual competitive structures close off some avenues of distribution and open up others.²⁸ Changing patterns of buyer behavior and new forms of technology add yet another dimension of change. Channel flows must be adapted to meet these changes. Innovative channel strategies and effective channel management are needed to make this happen.

Distribution through Intermediaries

A question asked since the time of ancient Greece is: Why do intermediaries so often stand between producers and the ultimate users of products? The question of the need for intermediaries in marketing channels has gained new currency in recent years with the rise of the Internet and E-commerce. As mentioned earlier in the chapter, the term *disintermediation*, a fancy way of saying "eliminate the middleman," has become popular jargon in the business lexicon. The thinking underlying disintermediation was based on the awesome technological capacity of the Internet to connect everybody to everybody else, including all producers with final consumers. But as also mentioned earlier in this chapter, disintermediation so far has not occurred on a major scale. The fact that the Internet and the World Wide Web connect hundreds of millions of people and institutions does not necessarily obviate the need for intermediaries.²⁹ In fact, as we proceed through the text it will become apparent that technology, while important and as potent as the Internet, is not the only determinant of what role, if any, intermediaries will play in marketing channels. Economic considerations are also very important in determining whether intermediaries will appear in marketing channels. Two of the most basic factors are (1) specialization/division of labor and (2) contact efficiency.

27. For a related discussion, see Frank V. Cespedes, "Channel Management Is General Management," *California Management Review* (Fall 1988): 98–120; and Donald W. Jackson and Bruce J. Walker, "The Channels Manager: Marketing's Newest Aide?" *Business Horizons* (Winter 1980): 52–58.

28. See Nicole Harris and Susan Corey, "Delta Eliminates Most Ticket Fees for Travel Agents," *Wall Street Journal* (March 15, 2002): B1, B4.

29. Melanie Trottman, "Airlines Jettison Incentives for Making Reservations Over the Internet," *Wall Street Journal* (June 25, 2001): B1.

Specialization and Division of Labor

The first clear exposition of the **specialization and division of labor** principle is generally attributed to Adam Smith's classic book *The Wealth of Nations*, published in 1776. In this work Smith cited an example from a pin factory. He noted that when the production operations necessary in the manufacture of pins were allocated among a group of workers so that each worker specialized in performing only one operation, a vast increase in output resulted over what was possible when this same number of workers individually performed all of the operations.

The logic of this principle has been well understood as it applies to a production setting. But this understanding is often lacking when specialization and division of labor is applied to a distribution situation, particularly when more than one firm is involved. Yet, whether applied to production or distribution, or within one firm or among several, the concept is fundamentally the same.³⁰ By breaking down a complex task into smaller, less complex ones and allocating them to parties who are specialists at performing them, much greater efficiency results. Figure 1.5 helps to illustrate this by comparing specialization and division of labor as applied to production versus distribution for a manufacturer of electric guitars. Though somewhat oversimplified, Figure 1.5 shows eight production tasks and seven distribution tasks involved in transforming wood and other components into an electric guitar, and then getting it to consumers. The eight production tasks have been allocated to various production stations in the factory, where workers who specialize in these tasks will perform them. On the right-hand side of Figure 1.5, various distribution tasks have been allocated among agents, wholesalers, and retailers, as well as the manufacturer and consumers.

The only difference in the application of the specialization and division of labor concept, as applied to production versus distribution in this figure, is that the production tasks have been allocated *intraorganizationally* whereas the distribution tasks have been allocated *interorganizationally*. Hence, just as the manufacturer's production manager should allocate production tasks on the basis of specialization and division of labor, so should the channel manager. Ideally he should allocate the distribution tasks to those firms that can perform them most efficiently. His contactual organization would then reflect an optimal allocation of the distribution tasks. In reality, of course, this is not always possible. Nevertheless, by thinking in terms of the specialization and division of labor principle as applied to distribution, the channel manager will be better equipped at least to approach an optimal allocation of distribution tasks. In Chapter 6, on designing the marketing channel, we will deal with this issue in greater detail.

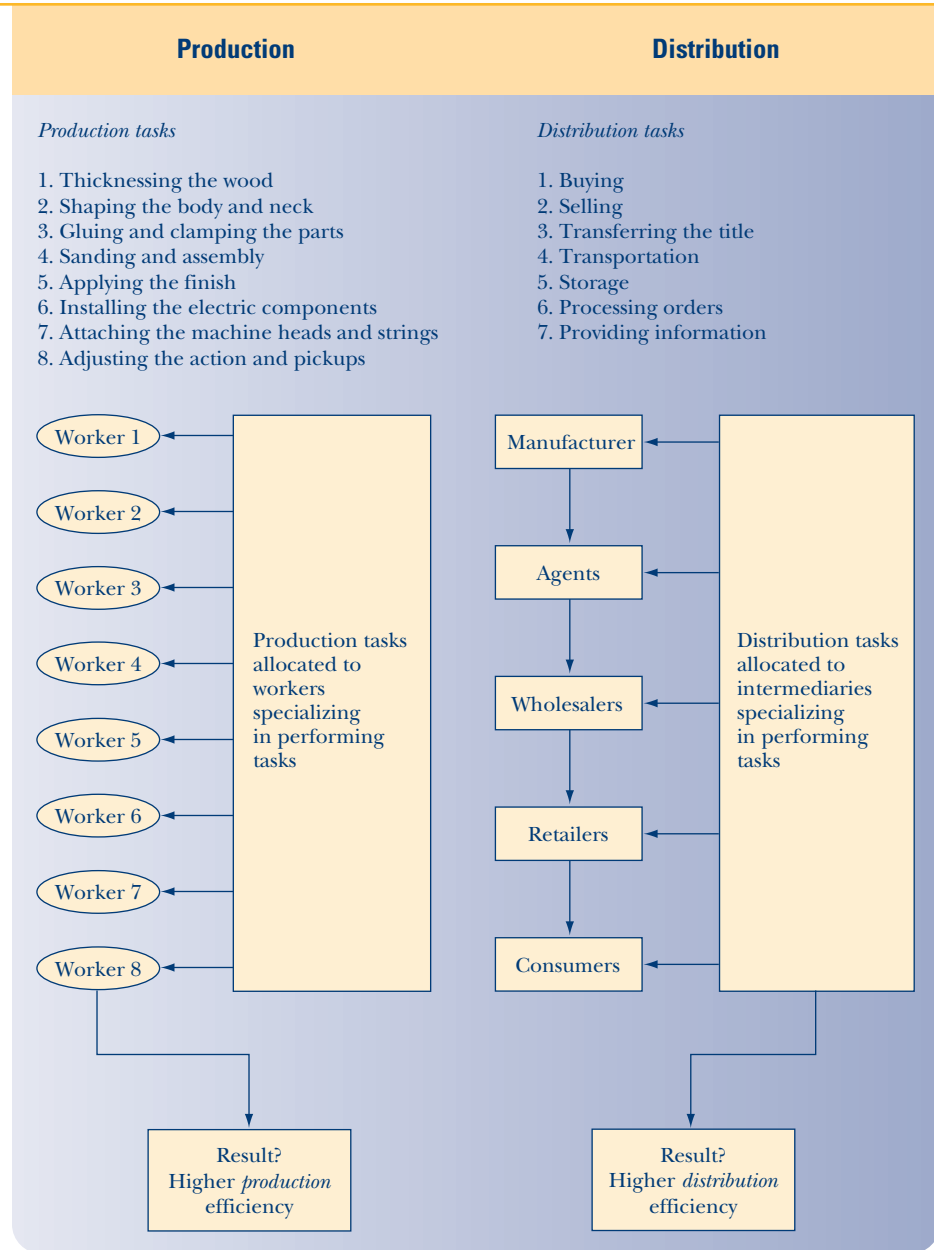
Contactual Efficiency

The second concept on which the framework for deciding whether to use intermediaries rests is contactual efficiency.³¹ From the channel manager's viewpoint, **contactual efficiency** is the level of negotiation effort between sellers and buyers relative to achieving a distribution objective. Thus, it is a relationship between an input (negotiation effort) and an output (the distribution objective). To illustrate this concept, consider the guitar manufacturer, hereafter referred to as the Granada Guitar Company. Suppose Granada sets a distribution objective of getting 500 music stores to carry its new line of electric guitars. Assuming the firm were to deal directly with the retailers, the input would be the level of negotiation effort it expends in

30. The theoretical basis for this argument can be found in George J. Stigler, "The Division of Labor Is Limited by the Extent of the Market," *Journal of Political Economy* (June 1951): 185–193. For a more recent but related analysis, see Walter Zinn and Michael Levy, "Speculative Inventory Management: A Total Channel Perspective," *International Journal of Physical Distribution Management* 18, 5 (1988): 34–39.

31. The theoretical basis for contactual efficiency can be found in Wroe Alderson, "Factors Governing the Development of Marketing Channels," in *Marketing Channels for Manufactured Products*, ed. Richard M. Clewett (Homewood, Ill.: Irwin, 1954), 5–22.

Figure 1.5
Specialization and
Division of Labor
Principle: Production
versus Distribution
for an Electric Guitar
Manufacturer



achieving the output—getting 500 music stores to carry the new line. To achieve this objective, Granada estimates it would need to have its sales force contact 2,500 stores, with many of these contacts requiring personal sales visits. Further, Granada believes it must use trade paper advertising to support the efforts of its salespeople. Management estimates it will take 1,500 sales calls, 1,000 telephone calls, and 10 trade magazine ads to finally achieve the objective. These figures are summarized in Table 1.2 along with some hypothetical estimates of dollar costs. Based on the figures shown in Table 1.2, Granada estimates it will cost \$88,000 to achieve this particular distribution objective if it works through retailers only.

Suppose Granada goes on to consider adding wholesale intermediaries to its contactual organization. Granada believes that 25 wholesalers carrying the new line would be sufficient

Negotiation Effort (Inputs)	Estimated Dollar Costs of Inputs	Distribution Objective (Output)	Contactual Efficiency
1,500 sales visits 1,000 phone calls 10 magazine ads	@ \$50 = \$75,000 @ 3 = 3,000 @ 1,000 = 10,000 Total \$88,000	Get 500 music stores to carry new guitar line.	Negotiation effort in dollar terms relative to achieving the distribution objective = \$88,000

Table 1.2
Example of Contactual Efficiency for the Granada Guitar Company, Distributing through Retailers Only

Negotiation Effort (Inputs)	Estimated Dollar Costs of Inputs	Distribution Objective (Output)	Contactual Efficiency
100 sales visits 100 phone calls 20 magazine ads	@ \$50 = \$5,000 @ 3 = 300 @ 1,000 = 20,000 Total \$25,300	Get 500 music stores to carry new guitar line.	Negotiation effort in dollar terms relative to achieving the distribution objective = \$25,300

Table 1.3
Example of Contactual Efficiency for the Granada Guitar Company, Distributing through Wholesalers

to get it accepted by the 500 retailers. Granada further estimates that it will take 100 personal sales calls on wholesalers, as well as 100 phone calls, to secure acceptance. However, Granada forecasts that double the advertising will be needed to support the salespeople (i.e., 20 magazine ads). These estimates are summarized in Table 1.3, which shows that the use of wholesalers provides a much higher level of contactual efficiency than if retailers alone were used. The reason for this is that the use of wholesalers has eliminated the need for direct contact with retailers, thereby greatly reducing the number of contacts needed.

This example points to an important relationship between contactual efficiency and the use of intermediaries: *The use of additional intermediaries will often increase the level of contactual efficiency.* This principle is further illustrated in Figure 1.6.

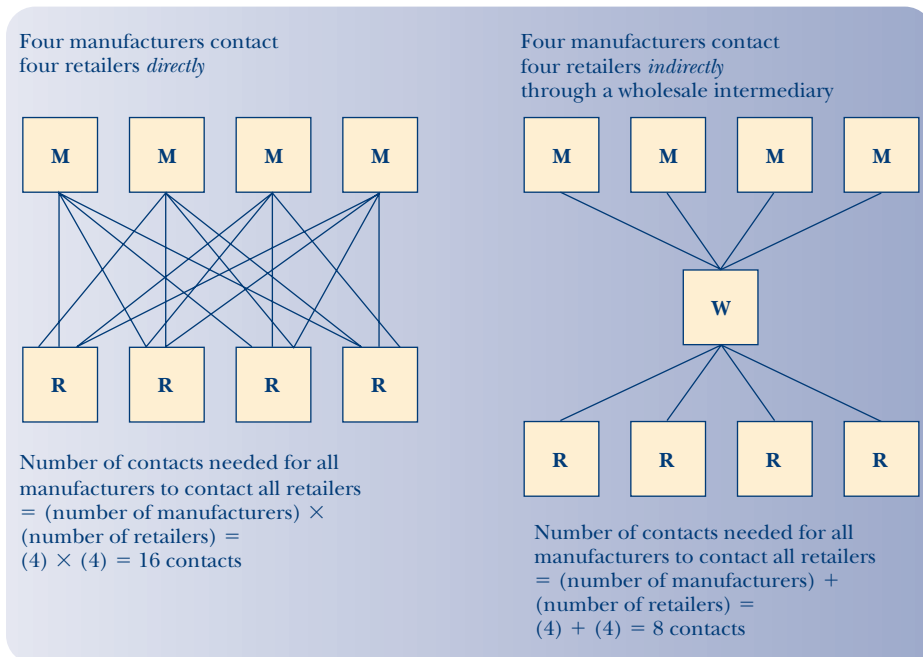


Figure 1.6
How the Introduction of an Additional Intermediary Reduces the Number of Contacts

This does not mean that considerations of contactual efficiency and specialization and division of labor are all that is needed to make a decision on intermediary usage. Many other variables (to be discussed in Part 2 of the text) must also be evaluated. But contactual efficiency and specialization and division of labor do provide the channel manager with a basic framework for incorporating these other variables into decisions on the use of intermediaries.

Channel Structure

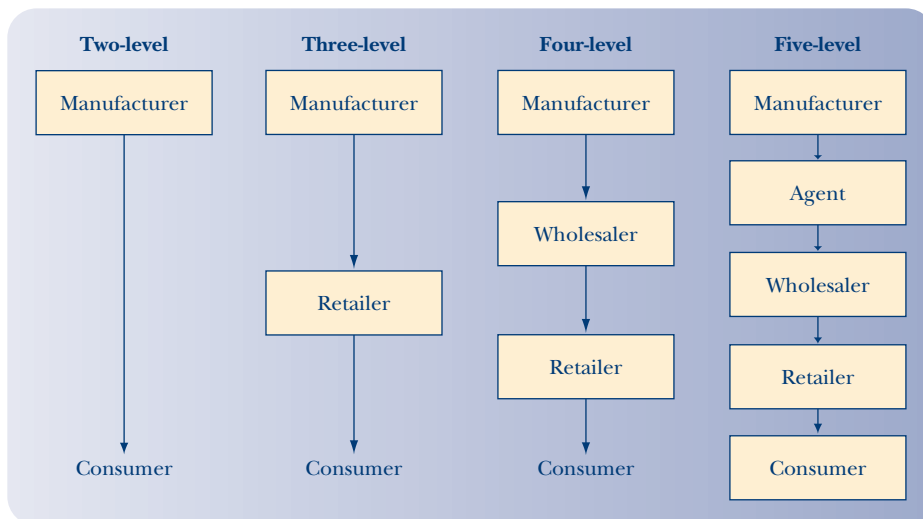
The concept of channel structure is one that is often not explicitly defined in the marketing literature.³² Perhaps the most typically discussed dimension is length—the number of levels of intermediaries in the channel (but as we shall see in Chapter 6, other dimensions of channel structure also exist).

When channel structure is presented, we frequently see diagrams such as that shown in Figure 1.7. Or sometimes symbolic notations such as the following are used:

$M \rightarrow C$	(two-level)	where A = Agent
$M \rightarrow R \rightarrow C$	(three-level)	C = Consumer
$M \rightarrow W \rightarrow R \rightarrow C$	(four-level)	M = Manufacturer
$M \rightarrow A \rightarrow W \rightarrow R \rightarrow C$	(five-level)	R = Retailer
		W = Wholesaler

While these approaches do convey a general idea of the kinds of participants in the marketing channel and the levels at which they appear, they do not explicitly define channel structure. Moreover, they fail to suggest the relationship between channel structure and channel management.

Figure 1.7
A Typical Portrayal of
Channel Structure for
Consumer Goods



32. For an insightful analysis of channel structure, see Gary L. Frazier, "On the Theory of Distribution Channel Structure," in *Proceedings of the 12th Paul D. Converse Symposium*, eds. Devanathan Sudharshan and Frederick E. Webster, Jr. (Chicago: American Marketing Association, 1986), 138–159. For a comprehensive in-depth analysis of one of the key dimensions of channel structure (the length of the channel), see Arun Sharma and Luis V. Dominguez, "Channel Evolution: A Framework for Analysis," *Journal of the Academy of Marketing Science* (Winter 1992): 1–15.

Our definition takes a managerial perspective by viewing **channel structure** as:

The group of channel members to which a set of distribution tasks has been allocated.

This definition suggests that in developing channel structure, the channel manager is faced with an **allocation decision**; that is, given a set of distribution tasks that must be performed to accomplish a firm's distribution objectives, the manager must decide how to allocate or structure the tasks. Thus, the structure of the channel will reflect the manner in which he or she has allocated these tasks among the members of the channel. For example, if after making the allocation decision the channel structure appears as $M \rightarrow W \rightarrow R \rightarrow C$, this means that the channel manager has chosen to allocate the tasks to his or her own firm as well as to wholesalers, retailers, and consumers.

In recent years, the term **multi-channel strategy** has been heard with increasing frequency. This simply means that the firm has chosen to reach its customers through more than one channel. A multi-channel marketing strategy naturally results in a multi-channel structure because distribution tasks have been allocated among more than one channel structure. With the emergence of E-commerce and online sales during the last few years of the twentieth century, many firms developed multi-channel structures that include online channels. For example, the multi-channel structure used for Polo by Ralph Lauren apparel (shown in Figure 1.8), consists of sales through upscale department stores and specialty retailers, its own company stores, and online sales through its Web site, <http://www.Polo.com>.

The use of multiple-channel structures to reach customers is not at all unusual in both consumer and business markets. In fact, firms that sell all of their products strictly through a single-channel structure are the exception today rather than the rule. Most firms already have or soon will use a multi-channel strategy, with many taking advantage of E-commerce technology to include online sales in their multi-channel structures.³³ Figures 1.9 through 1.12 illustrate channel structures for a variety of products and services.

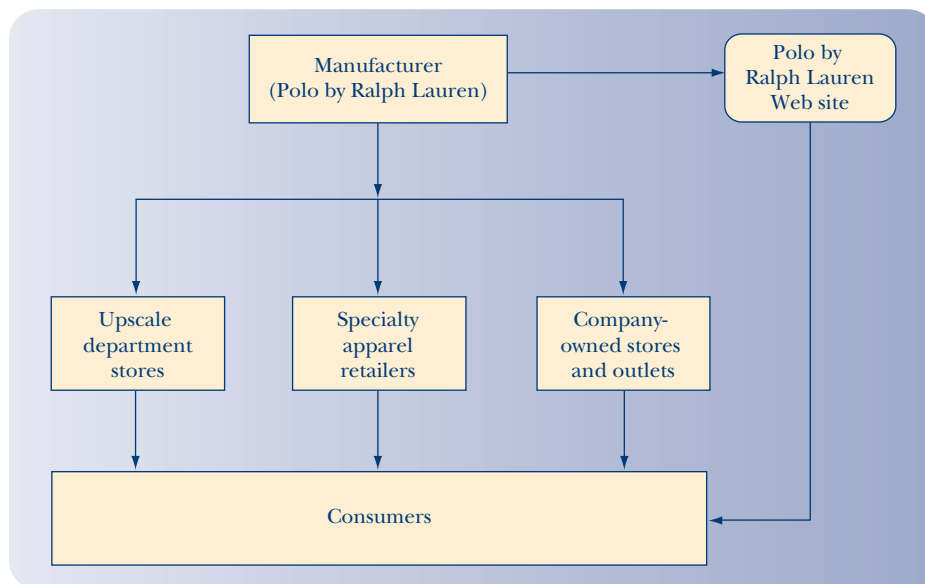


Figure 1.8
Marketing Channel
Structure for Polo by
Ralph Lauren Apparel

33. Kathleen Seiders, Leonard L. Berry, and Larry G. Gresham, "Attention Retailers! How Convenient Is Your Convenience Strategy?" *Sloan Management Review* (Spring 2000): 79–89.

Figure 1.9
Marketing Channels for Consumer Electronics Products

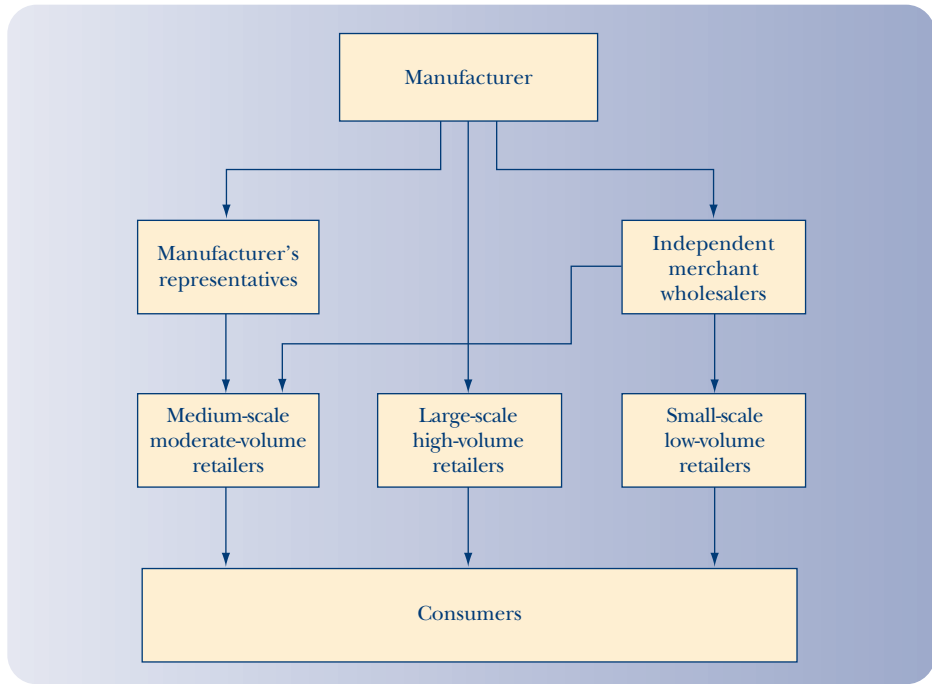
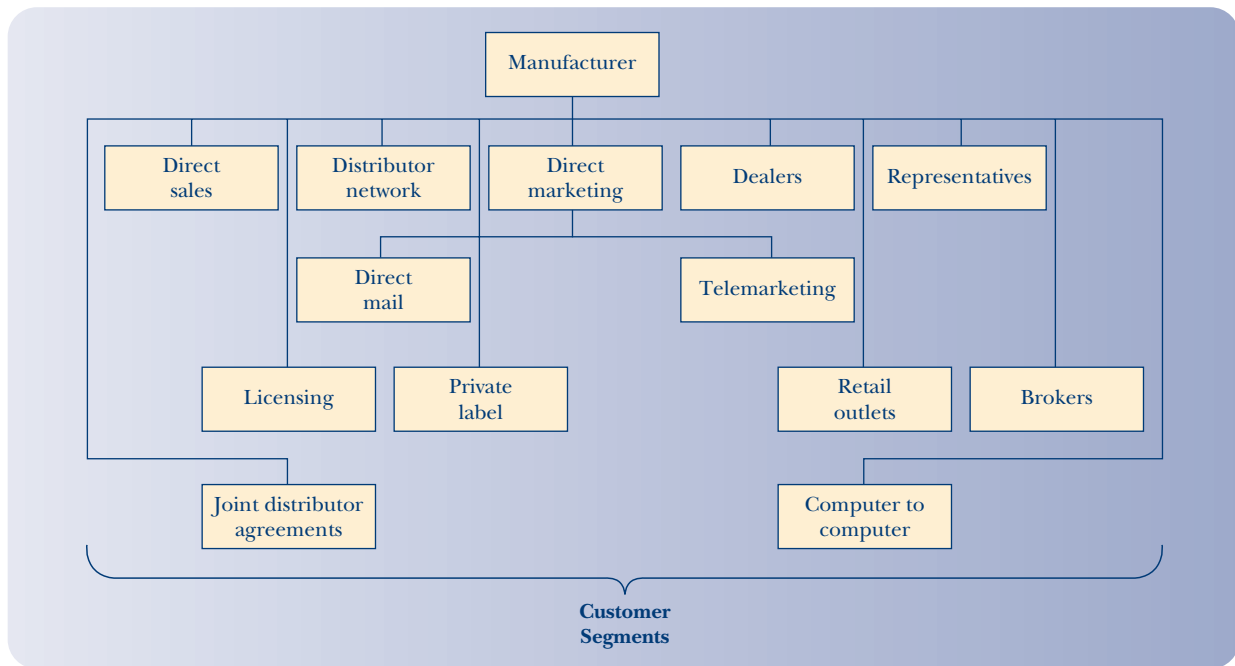


Figure 1.10
Alternative Channel Structures for Business-to-Business Markets



Source: Adapted from David Perry, "How You'll Manage Your 1990s Distribution Portfolio," *Business Marketing* 74 (June 1989): 54.

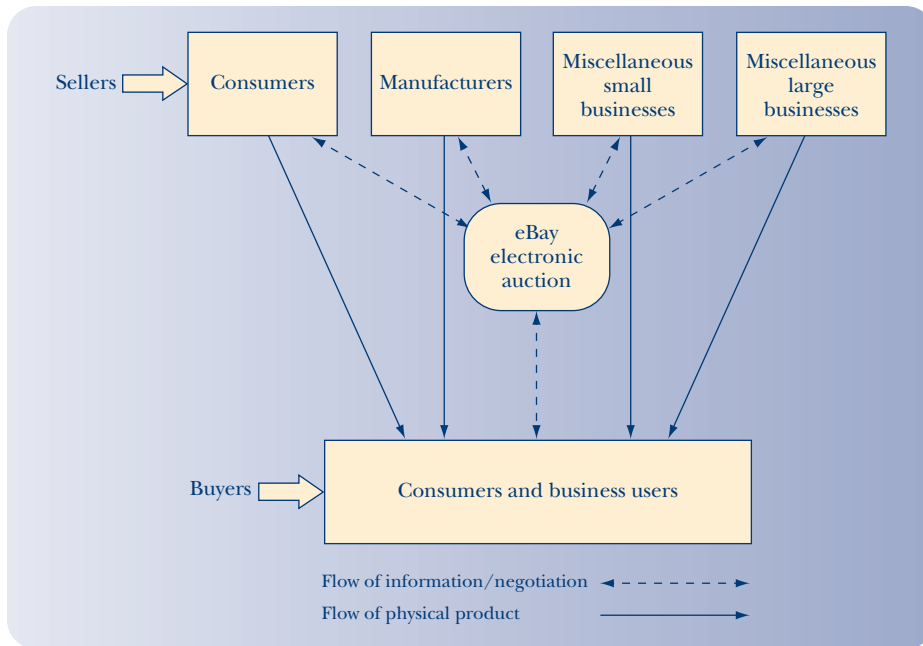


Figure 1.11
Channel Structure
for eBay Showing
Information/Negotiation
and Product Flows

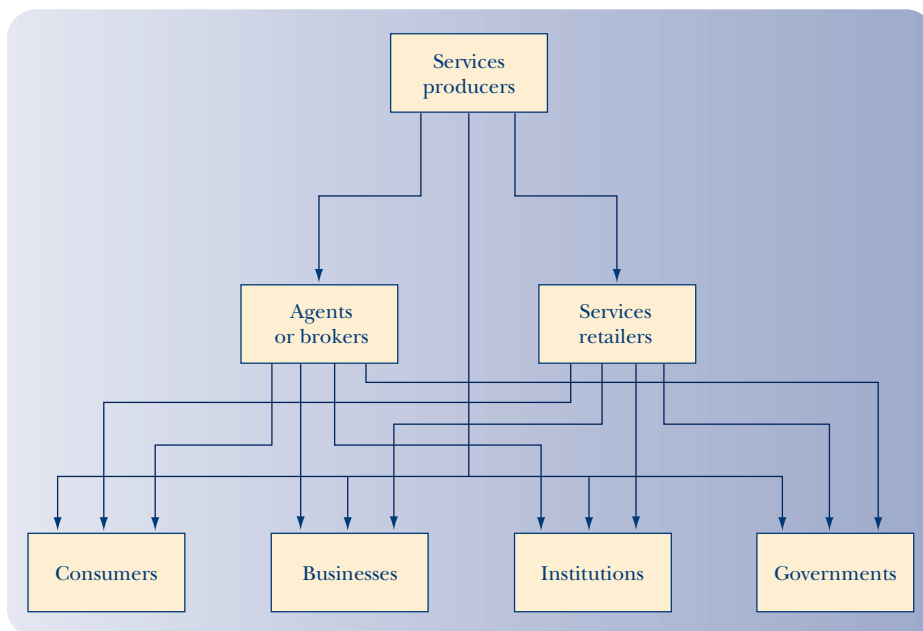


Figure 1.12
Marketing Channels
for Services

As pointed out earlier, the primary paradigms for making such allocation decisions are specialization, division of labor, and contactual efficiency. Ideally the channel manager would like total control over the allocation of distribution tasks so that he or she could assign these tasks to the particular firms or parties who are best suited to perform them. However, since the channel includes members that are independent firms, and because the channel is subject to environmental constraints, in reality the channel manager does not often have total control of the allocation of distribution tasks.

In Part 2 of the text we will discuss the problems and constraints faced by the channel manager in attempting to develop an optimal channel structure.

Ancillary Structure

We have defined the marketing channel as including only those participants who perform the negotiatory functions of buying, selling, and transferring title, and hence it follows that those who do *not* perform these functions are not members of the channel structure. We will consider these nonmember participants or facilitating agencies as belonging to the ancillary structure of the marketing channel. More specifically, we define **ancillary structure** as:

The group of institutions (facilitating agencies) that assists channel members in performing distribution tasks.

The basic decision facing the channel manager in attempting to develop ancillary structure is the same as for developing channel structure; that is, he or she must attempt to allocate distribution tasks to those parties best suited to performing them. Because the channel manager is dealing with nonmember channel participants, however, the problems faced in developing and managing the ancillary structure are likely to be less complex than those encountered in developing (and managing) channel structures. This is because facilitating firms do not play a part in the channel decisions that ultimately control the distribution of goods and services to their target markets. Rather, the role of facilitating agencies comprising the ancillary structure is one of providing services to the channel members *after the basic channel decisions have already been made*.

The Black & Decker Corporation (B&D), one of the world's leading manufacturers of power tools, will serve as an example. B&D sells many of its industrial power tools through independent wholesalers (industrial distributors) who in turn sell these products to manufacturers, contractors, repair shops, schools, government agencies, and other industrial market segments. B&D's consumer power tools are sold through retailers such as hardware stores, home center stores, mass merchandisers, automotive stores, and others who buy these products either directly from B&D or through wholesalers. For these marketing channels to operate efficiently, a number of nonnegotiable tasks such as transportation, storage, insurance, financing, and advertising must be performed. In many cases, it is more advantageous for B&D, as well as its distributors and dealers, to "farm out" these tasks to facilitating agencies (the ancillary structure) rather than perform the tasks themselves. For instance, B&D uses common carriers to transport its power tools to industrial distributors, rather than maintaining its own fleet of trucks. Similarly, it relies on commercial insurance companies to protect against risks while the products are in transit, rather than attempting to self-insure. B&D also at times uses independent advertising agencies to promote its products rather than develop all of its advertising in-house. Wholesalers and retailers of B&D power tools also use facilitating agencies to perform some of these tasks rather than trying to undertake them alone.

In developing the ancillary structure to perform these tasks, the channel manager deals with facilitating agencies who are outside of the channel decisionmaking process and who

generally do not have as great a stake in the channel as do the channel members. Thus the trucking company that transports a load of power tools from a B&D manufacturing plant to an independent industrial distributor is concerned only with the relatively simple task of moving the products from point A to point B. Furthermore, the channel manager does not have to negotiate or deal with them on the same basis as channel members. For example, it is a formidable task for B&D to convince independent industrial distributors (channel members) to stock and enthusiastically promote its DeWalt line of power tools against the competition of other manufacturers such as Porter-Cable, Makita, or Ryobi. In developing channel structure, B&D is also faced with such difficult issues as the proper choice of channel members, how much of a role each will play in decision making, how control will be exercised, how performance will be evaluated, and many other issues to be discussed throughout this text.



SUMMARY

Marketing channels that make products and services readily available to customers when, where, and how they are needed had for some time taken a “back seat” to the other strategic variables of the marketing mix—product, price, and promotion. But in recent years this relative neglect of marketing channels has been changing dramatically. Four factors account for the growing emphasis on marketing channel strategy:

1. The explosion of information technology and E-commerce
2. The greater difficulty in gaining a sustainable competitive advantage
3. The growing power of distributors, especially giant retailers in marketing channels
4. The need to reduce distribution costs

All of these factors have combined to make marketing channels a key component of the larger field of strategic marketing management. Effective and efficient marketing channels have become more important than ever for competing successfully in highly competitive markets in the United States and all over the world.

Although there are a number of ways to view marketing channels, a managerial viewpoint mainly from the perspective of producing and manufacturing firms is used in this text. In this context, the marketing channel is defined as the external contactual organization that management operates to achieve its distribution objectives. Only parties who perform the negotiatory functions of buying, selling, and transferring title are considered to be members of the marketing channel.

The basic marketing mix strategy model provides the framework for examining the marketing channel from a marketing management perspective. In this framework, marketing channel strategy and management fit under the distribution variable of the four basic strategic variables of the marketing mix (product, price, promotion, and distribution). The channel manager must develop and operate the external contactual organization (the marketing channel) in such a way as to support and enhance the other strategic variables of product, price, and promotion in the marketing mix in order to meet the demands of customers.

Channel strategy is a more basic and comprehensive component of distribution strategy than is logistics management. Channel strategy is concerned with the *entire process* of setting up and operating the contactual organization that is responsible for meeting the firm’s distribution objectives, whereas logistics management is more narrowly focused on providing product availability at the appropriate time and place in the marketing channel.

The links that tie channel members and other agencies together in the distribution of goods and services are referred to as channel flows. From a channel management standpoint,

the most important of these flows are (1) product flow, (2) negotiation flow, (3) ownership flow, (4) information flow, and (5) promotion flow. The channel manager must effectively manage and coordinate all of these flows to achieve the firm's distribution objectives.

A basic decision facing the channel manager in the development of the marketing channel is whether to use intermediaries such as wholesalers and retailers in the contactual organization and whether facilitating agencies should also be used. The basis for making this decision rests on the two fundamental concepts of specialization and division of labor and contactual efficiency.

Channel structure refers to the group of channel members to which a set of distribution tasks has been allocated. In many cases, a particular firm might use a combination of different channel structures to implement its distribution strategy. This approach is now frequently referred to as a multi-channel structure, especially when one of the channel structures involves E-commerce via online sales in addition to conventional channels. Ancillary structure is the group of institutions and parties that assists channel members in performing distribution tasks. The channel manager would like to develop optimum channel and ancillary structures based on specialization, division of labor, and contactual efficiency. The ability to do so is limited, however, because the interorganizational setting in which the channel manager must operate reduces the capacity to control the independent channel members and facilitating agencies.

Review Questions

1. Why have marketing channels enjoyed increased attention in marketing as a strategic area for competing in the market?
2. How does a management perspective of the marketing channel differ from some other views of the channel?
3. What is the distinction between interorganizational management and intra-organizational management?
4. Is management of the marketing channel the only instance of interorganizational management for a producing or manufacturing firm?
5. Operating the channel does not imply total control of the channel. Can you think of an example where the channel manager does not have total control of the channel but is still able to operate it?
6. Discuss the relationship between channel management and the marketing mix.
7. What is the difference between channel strategy and logistics management?
8. Identify the various flows in marketing channels and the direction of the flows. Why is the concept of channel flows useful for a better understanding of channel management?
9. Could the product flow operate independently from other channel flows?
10. Discuss the concept of specialization and division of labor as it applies to marketing channels.

11. Even though specialization and division of labor is the fundamental basis for allocating distribution tasks, can the channel manager make decisions about using intermediaries and facilitating agencies *solely* on that basis? Explain why or why not.
12. What is contactual efficiency? Can you think of examples of contactual efficiency that do not occur in a marketing channels context? If so, list.
13. Discuss the distinction between channel structure and ancillary structure.
14. Why is it so difficult for the channel manager to develop a truly optimal channel structure?

Issues for Discussion

1. Making products conveniently available to customers when, where, and how they want them is the essence of what marketing channels are expected to do. But does this apply to products such as Southern-style barbecue cooked by famous regional restaurants such as Big Bob Gibson's in Alabama or Corky's and the Rendezvous in Memphis? After all, former presidents (Bill Clinton), former politicians (Newt Gingrich), and even rock stars (the Rolling Stones) have gone many miles out their way while on tour to sink their teeth into these mouth-watering recipes. Well, it turns out you don't have to be a president or a rock star, and you don't have to be on tour to get these fabulous barbecues. Mail-order and online marketing channels have made them available to anyone in the U.S. (and some foreign countries) who is willing to pay the high packing and shipping costs, which can run about three times the price of the barbecue for overnight delivery to your doorstep. Apparently an awful lot of people think the price is worth it, because by the year 2000 over 10 million pounds of this tasty pork was sold via these channels!

Comment on the value added to the product through mail-order and online marketing channels that justifies a threefold increase in the price of the barbecue compared to having it onsite at the restaurants.

2. Susan Jensen, a marketing manager for a major consumer package goods manufacturer, is very upset with the sales results of the new oat bran cookies her company introduced three months ago. She believes that an important factor in the lackluster sales results is that too many supermarkets across the country were not featuring the product in giant end-of-aisle displays recommended by the manufacturer to evoke consumer impact and awareness. "I feel like hitting those store managers over the head for not featuring this product—if only I had more control over these guys," remarked a frustrated and angry Susan Jensen.

Discuss this situation in the context of the definition of the marketing channel presented in the text.

3. The recording industry, including the major record companies, and music retailers are very uncertain about what the Internet will do to their future business prospects and even their very existence. The free exchange of music over the Internet is the heart of the problem. In fact, during the first year of the new millennium, blank CDs, used to store downloaded music, outsold prerecorded CDs for the first time in history. So, instead of a channel structure for recorded music that flows from producer to retailer to consumer in the form of a prerecorded CD, the emerging channel structure might increasingly be disintermediated into consumer-to-consumer channels via the Internet.

What do *you* think will happen in the future to existing music channels for prerecorded CDs? Discuss some alternative scenarios. How do your scenarios relate to the flows in marketing channels?

4. Commerce Bank, a regional banking chain headquartered in Cherry Hill, New Jersey, has become the fastest-growing bank in the U.S. However, the bank's founder and CEO, Vernon W. Hill, does not think of his company as a bank, but as a retailer that happens to sell banking products. This mindset has created a very different banking channel—one that is driven by the needs and desires of consumers rather than the aloof culture of the banking industry. Commerce Bank branches are open seven days a week and well into the evening, have friendly tellers available at all times, and provide an atmosphere and service level that customers would expect to find at a great retailer rather than at a bank. Yet even with all its "bricks and mortar" branches, Commerce Bank has also taken a multi-channel route by providing its customers with an online banking channel. About one third of its customers make use of the online channel—the highest penetration rate in the industry. It wasn't very long ago that banking industry pundits said that retail banking was dead. Commerce Bank, with its customer-driven marketing channels, has shown that it is still very much alive. Will other banks be able to quickly copy what Commerce is doing? According to Vernon Hill, the very special culture underlying Commerce Bank's successful channel strategy cannot be easily duplicated by competitors.
Do you think Commerce Bank has created a sustainable competitive advantage through its customer-driven channel strategy?
5. The TV reporter for a network news show is walking through a cornfield with a downtrodden-looking farmer in Iowa. As they continue through the field, the farmer comments: "My family and I have worked real hard over the years to produce a good crop, but we hardly get much of a price for it. But when I see how much they want for corn and just about any corn products in the supermarkets, I can't believe it. The consumer is paying a high price while I'm getting a very low price, so somebody must be making a lot of money in between." The reporter then turns to the camera and in a melodramatic style intones: "As you've just seen, we've talked with a farmer who, in spite of all his hard work, can hardly

make a living. But you and I both know how high prices are in the supermarkets. Are we being ripped off by a bunch of middlemen?"

Comment on the farmer's lament to the reporter and the reporter's remarks to the TV audience in light of the relevant channel concepts discussed in this chapter.

6. The world's largest online auction firm, eBay, best known for offering antiques and collectibles such as baseball cards and Pez dispensers, has been expanding to include larger items such as computers and automobiles. With its acquisition of HomesDirect.com, eBay has made a major move into an even larger item—real estate in the form of auctioning foreclosed homes on the Internet. While eBay had already dabbled in real estate, selling a dozen or so properties per day, HomesDirect.com sells several hundred per day and well over 100,000 per year. Traditional real estate firms are still skeptical about the future growth prospects for online real estate marketing channels. They argue that most potential buyers still need the face-to-face help of skilled real estate professionals to deal with the complexities of real estate transactions.

Would you buy a home over the Internet from eBay's HomesDirect.com division? Why or why not? Discuss the advantages as well as the limitations of the Internet as a marketing channel for real estate.