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17 Designing and Managing Integrated Marketing Channels

Successful value creation needs successful value delivery. Instead of limiting their focus to their immediate suppliers, distributors, and customers, holistic marketers are examining the whole supply chain as a value network, including their suppliers' suppliers upstream and their distributors' customers downstream. They are also looking at how technology is changing the way customers shop and retailers sell and finding new and different means to distribute and service their offerings. Consider how L.L.Bean develops strong customer ties with a well-executed channel strategy.[1]

L.L.Bean's founder Leon Leonwood (L.L.) Bean returned from a Maine hunting trip in 1911 with cold, damp feet—and a revolutionary idea for stitching leather uppers to workmen's rubber boots to create a comfortable, functional boot. To a mailing list of hunters, Bean sent a three-page flier describing the benefits of his new Maine Hunting Shoe and backing it with a complete guarantee. The shoe was not an initial success. Of the first 100 pairs ordered, 90 were returned when the tops and bottoms separated. True to his word, Bean refunded the purchase price and fixed the problem. L.L.Bean quickly became known as a trusted source for reliable outdoor equipment and expert advice. The company's guarantee of 100 percent satisfaction is still at the core of its business, as is its original Golden Rule, "Sell good merchandise at a reasonable profit, treat your customers like human beings, and they will always come back for more." Today, it is a $1.5 billion company, selling through its famous catalogs as well as online and in retail stores. L.L Bean has also expanded globally, with stores in Japan and China. To better meet its U.S. customers' needs, the company launched free shipping in 2011. Online it has opened up to customer ratings and reviews, given customers the opportunity to chat and e-mail with customer service, and introduced a "click to call" system that triggers a customer service call within two minutes. Ranked #1 in customer service by Bloomberg Businessweek, L.L.Bean monitors customer feedback closely. When one of its customer-favorite products, Supima Cotton Fitted Sheets, began to be criticized in online reviews, the company quickly pulled the product from its Web site to investigate. It turned out that a wrinkle-resistance treatment mistakenly added by a contractor was causing the cotton fabric to tear or shred. L.L.Bean immediately offered new sheets to the 6,300 customers who had purchased the defective set and destroyed the remaining faulty products.

With the advent of e-commerce (selling online) and m-commerce (selling via mobile phones and tablets), customers are buying in ways they never have before. Companies today must build and manage a continuously evolving and increasingly complex channel system and value network. In this chapter, we consider strategic and tactical issues in integrating marketing channels and developing value networks. We will examine marketing channel issues from the perspective of retailers, wholesalers, and physical distribution agencies in Chapter 18.

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Marketing Channels and Value Networks

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

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

Channels of all types play an important role in the success of a company and affect all other marketing decisions. Marketers should judge them in the context of the entire process by which their products are made, distributed, sold, and serviced. We consider all these issues in the following sections.

THE IMPORTANCE OF CHANNELS

A **marketing channel system** is the particular set of marketing channels a firm employs, and decisions about it are among the most critical ones management faces. In the United States, channel members as a group have historically earned margins that account for 30 percent to 50 percent of the ultimate selling price. In contrast, advertising typically has accounted for less than 5 percent to 7 percent of the final price.[3] One of the chief roles of marketing channels is to convert potential buyers into profitable customers. Marketing channels must not just *serve* markets, they must also *make* them.[4]

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

In managing its intermediaries, the firm must decide how much effort to devote to push and to pull marketing. A **push strategy** uses the manufacturer's sales force, trade promotion money, or other means to induce intermediaries to carry, promote, and sell the product to end users. This strategy is particularly appropriate when there is low brand loyalty in a category, brand choice is made in the store, the product is an impulse item, and product benefits are well understood.

In a **pull strategy** the manufacturer uses advertising, promotion, and other forms of communication to persuade consumers to demand the product from intermediaries, thus inducing the intermediaries to order it. This strategy is particularly appropriate when there is high brand loyalty and high involvement in the category, when consumers are able to perceive differences between brands, and when they choose the brand before they go to the store.

Top marketing companies such as Apple, Coca-Cola, and Nike skillfully employ both push *and* pull strategies. A push strategy is more effective when accompanied by a well-designed and well-executed pull strategy that activates consumer demand. On the other hand, without at least some consumer interest, it can be very difficult to gain much channel acceptance and support, and vice versa for that matter.

MULTICHANNEL MARKETING

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

When this doesn't happen, channel conflict, excessive cost, or insufficient demand can result. Launched in 1976, Dial-a-Mattress successfully grew for three decades by selling mattresses directly over the phone and later online. A major expansion into 50 brick-and-mortar stores in major metro areas was a failure, however. Secondary locations, chosen because management considered prime locations too expensive, could not generate enough customer traffic. The company eventually declared bankruptcy.[5]

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On the other hand, when a major catalog and Internet retailer invested significantly in brick-and-mortar stores, different results emerged. Customers near the store purchased through the catalog less frequently, but their online purchases were unchanged. As it turned out, customers who liked to spend time browsing were happy to either use a catalog or visit the store; those channels were interchangeable. Customers who shopped online, on the other hand, were more transaction-focused and interested in efficiency, so they were less affected by the introduction of stores. Returns and exchanges at the stores were found to increase because of ease and accessibility, but extra purchases made by customers returning or exchanging at the store offset any revenue deficit.[6]

Research has shown that multichannel customers can be more valuable to marketers.[7] Nordstrom found that its multichannel customers spend four times as much as those who only shop through one channel, though some academic research suggests that this effect is stronger for hedonic products (apparel and cosmetics) than for functional products (office and garden supplies).[8]

INTEGRATING MULTICHANNEL MARKETING SYSTEMS

Most companies today have adopted multichannel marketing. Disney sells its videos through multiple channels: movie rental merchants such as Netflix and Redbox, Disney Stores (now owned and run by The Children's Place), retail stores such as Best Buy, online retailers such as Disney's own online stores and Amazon.com, and the Disney Club catalog and other catalog sellers. This variety affords Disney maximum market coverage and enables it to offer its videos at a number of price points.[9] Here are some of the channel options for leather-goods maker Coach.[10]

COACH Coach markets a high-end line of luxury handbags, briefcases, luggage, and accessories. In its 2013 fiscal year 10-K, the company describes its multichannel global distribution model as follows: "Coach products are available in image-enhancing locations globally wherever our consumer chooses to shop including: retail stores and factory outlets, directly operated shop-in-shops, online, and department and specialty stores. This allows Coach to maintain a dynamic balance as results do not depend solely on the performance of a single channel or geographic area." The North America segment consists of direct-to-consumer and indirect channels and includes sales to consumers through 351 company-operated retail stores, including the Internet, and sales to wholesale customers and distributors. Coach began as a U.S. wholesaler and still sells to 1,000 U.S. department-store locations, such as Macy's (including Bloomingdale's), Dillard's, Nordstrom, Saks Fifth Avenue, and Lord & Taylor, often within a tightly controlled shop-within-a-shop, as well as on some of those retailer's Web sites. This segment represented approximately 69 percent of the company's total net sales in fiscal 2013. The International segment sells to consumers online and through company-operated stores in Japan and mainland China, Hong Kong, Macau, Singapore, Taiwan, Malaysia, and Korea and to wholesale customers and distributors. Coach also has store-in-store offerings in Japan and China inside major department stores. The International segment represented approximately 31 percent of total net sales in fiscal 2013. Finally, Coach has licensing relationships with Movado (watches), Jimlar (footwear), and Marchon (eyewear). These licensed products are sometimes sold in other channels such as jewelry stores, high-end shoe stores, and optical retailers as Coach continues to broaden its meaning from a "bag brand" to a whole lifestyle brand.

Source: © Jeff Greenberg "0 people images"/Alamy

Coach uses a broad range of channels to better sell its expanding product lines.

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

An **integrated marketing channel system** is one in which the strategies and tactics of selling through one channel reflect the strategies and tactics of selling through one or more other channels. Adding more channels gives companies three important benefits. The first is increased market coverage. Not only are more customers able to shop for the company's products in more places, as noted above, but those who buy in more than one channel are often more profitable than single-channel customers.[11] The second benefit is lower channel cost—selling online or by catalog and phone is cheaper than using personal selling to reach small customers. The third is the ability to do more customized selling—such as by adding a technical sales force to sell complex equipment.

There is a trade-off, however. New channels typically introduce conflict and problems with control and cooperation. Two or more may end up competing for the same customers.[12] Clearly, companies need to think through their channel architecture and determine which channels should perform which functions.[13] Figure 17.1 shows a simple grid to help make channel architecture decisions. It consists of major marketing channels (as rows) and the major channel tasks to be completed (as columns).[14]

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

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

Multichannel marketers also need to decide how much of their product to offer in each of the channels. Patagonia views the Web as the ideal channel for showing off its entire line of goods, given that its 88 retail

Demand-generation Tasks

Marketing Channels and Methods (VENDOR)	Gather relevant information	Develop & disseminate communications	Reach price agreements	Place orders	Acquire funds for inventories	Assume risks	Facilitate product storage & movement	Facilitate payment	Oversee ownership transfer	
Internet										CUSTOMER
National account management										
Direct sales										
Telemarketing										
Direct mail										
Retail stores										
Distributors										
Dealers and value-added resellers										

| Fig. 17.1 |

The Hybrid Grid

Source: Adapted from Rowland T. Moriarty and Ursula Moran, "Marketing Hybrid Marketing Systems," *Harvard Business Review*, November–December, 1990, p. 150.

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Source: © ZUMA Press, Inc/Alamy

Outdoor equipment supplier REI is known for its seamless blending of online and offline channels.

locations are limited by space to offering a selection only, and even its catalog promotes less than 70 percent of its total merchandise.[15] Other marketers prefer to limit their online offerings, theorizing that customers look to Web sites and catalogs for a "best of" array of merchandise and don't want to have to click through dozens of pages. Here's a company that has carefully managed its multiple channels.[16]

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

VALUE NETWORKS

A supply chain view of a firm sees markets as destination points and amounts to a linear view of the flow of ingredients and components through the production process to their ultimate sale to customers. The company should first think of the target market, however, and then design the supply chain backward from that point. This strategy has been called **demand chain planning**.[17]

A broader view sees a company at the center of a **value network**—a system of partnerships and alliances that a firm creates to source, augment, and deliver its offerings. A value network includes a firm's suppliers and its suppliers' suppliers and its immediate customers and their end customers. It also incorporates valued relationships with others such as university researchers and government approval agencies.

A company needs to orchestrate the work of these parties to deliver superior value to the target market. Oracle relies on 15 million developers—the largest developer community in the world.[18] Apple Developer—where folks create iPhone apps for the Apple operating system—has 275,000 registered iOS members. Developers keep 70 percent of any revenue their products generate; Apple gets 30 percent. After releasing more than 850,000 apps that were downloaded 45 billion times in the first five years, Apple has paid out almost $9 billion.[19]

Demand chain planning yields several insights.[20] First, the company can estimate whether more money is made upstream or downstream, in case it can integrate backward or forward. Second, the company is more aware of disturbances anywhere in the supply chain that might change costs, prices, or supplies. Third, companies can go online with their business partners to speed communications, transactions, and payments; reduce costs; and increase accuracy. Ford not only manages numerous supply chains but also sponsors many B-to-B Web sites and exchanges.

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Managing a value network means making increasing investments in information technology (IT) and software. Firms have introduced supply chain management (SCM) software and invited such software firms as SAP and Oracle to design comprehensive *enterprise resource planning* (ERP) systems to manage cash flow, manufacturing, human resources, purchasing, and other major functions within a unified framework. They hope to break up departmental silos—in which each department acts only in its own self-interest—and carry out core business processes more seamlessly. Most, however, are still a long way from truly comprehensive ERP systems.

Marketers, for their part, have traditionally focused on the side of the value network that looks toward the customer, adopting customer relationship management (CRM) software and practices. In the future, they will increasingly participate in and influence their companies' upstream activities and become network managers, not just product and customer managers.

THE DIGITAL CHANNELS REVOLUTION

The digital revolution is profoundly transforming distribution strategies. With customers—both individuals and businesses—becoming more comfortable buying online and the use of smart phones exploding, traditional brick-and-mortar channel strategies are being modified or even replaced.

Online retail sales (or e-commerce) have been growing at a double-digit rate; apparel and accessories, consumer electronics, and computer hardware are the three fastest-growing categories. Skeptics initially felt apparel wouldn't sell well online, but easy returns, try-on tools, and customer reviews have helped counter the inability to try clothes on in the store.

As brick-and-mortar retailers promote their online ventures and other companies bypass retail activity by selling online, they all are embracing new practices and policies. As in all marketing, customers hold the key. Customers want the advantages both of digital—vast product selection, abundant product information, helpful customer reviews and tips—and of physical stores—highly personalized service, detailed physical examination of products, an overall event and experience. They expect seamless channel integration so they can:[21]

- Enjoy helpful customer support in a store, online, or on the phone
- Check online for product availability at local stores before making a trip
- Find out in-store whether a product that is unavailable can be purchased and shipped from another store to home
- Order a product online and pick it up at a convenient retail location
- Return a product purchased online to a nearby store of the retailer
- Receive discounts and promotional offers based on total online and offline purchases

Retailers and manufacturers are responding. Consider some of the changes being made by retail giant Walmart.[22]

WALMART With a huge investment in brick-and-mortar stores, many entrenched executives, and long-established policies, Walmart was slow to embrace online and mobile technology and had online operations accounting for less than 2 percent of its global sales. Then the company decided to make its digital strategy a priority, giving customers anytime, anywhere access to Walmart by combining mobile, online, and physical stores. After acquiring social-media start-up Kosmix, known for its strong expertise in search and analytics, it established its @WalmartLabs group in Silicon Valley, leading to company innovations such as smart-phone payment technology, mobile shopping applications, and Twitter-influenced product selection for stores. Walmart found that many of its core customer group who made $30,000 to $60,000 a year were shopping from its Web site in large numbers and often on smart phones rather than computers. Always a wizard with logistics, Walmart adopted a "ship from store" practice that uses its more than 4,000 U.S. stores as warehouses to fulfill online orders quickly. The company is also exploring same-day shipping. It improved the search engine on its Web site, increasing its "browsers to buyers" conversion by as much as 15 percent; launched its Shopycat gift recommendation app, which uses social media to suggest gifts; introduced its Scan and Go app so customers can automatically apply coupons when checking out; and added an in-aisle mobile-scanning system to speed check-out. A top priority for Walmart is its smart-phone app. Users of the app spend more and frequent the store twice as often as non-users. When near a store, the app flips into "store mode" to help locate items on a shopping list and make additional recommendations, provide a digital version of the latest circulars, and highlight new products available in the store.

Retailers and manufacturers are assembling massive amounts of social, mobile, and location (SoMoLo) information they can mine to learn about their customers. They are using software that closely monitors what's selling where and at what price in order to adjust their offerings and prices.[23] The goal for many marketers is to develop a

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Source: © IanDagnall Computing/Alamy

By skillfully combining mobile, online, and physical stores, Walmart's goal is to give customers access to its merchandise anytime, anywhere.

customized "next best offer" (NBO) that takes into account customers' attitudes and behavior, purchase (product or service), and shopping channel (in store or online) and the marketer's goal with respect to those consumers, whether it is to increase sales, say, or build loyalty.[24]

The Role of Marketing Channels

Why does a producer delegate some of the selling job to intermediaries, relinquishing control over how and to whom its products are sold? Through their contacts, experience, specialization, and scale of operation, intermediaries make goods widely available and accessible to target markets, offering more effectiveness and efficiency than the selling firm could achieve on its own.[25]

Source: © michael going/Alamy

Many manufacturers would find it cost prohibitive to open up their own stores—their best options are to tap into established dealer and retailer networks.

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TABLE 17.1	Channel Member Functions

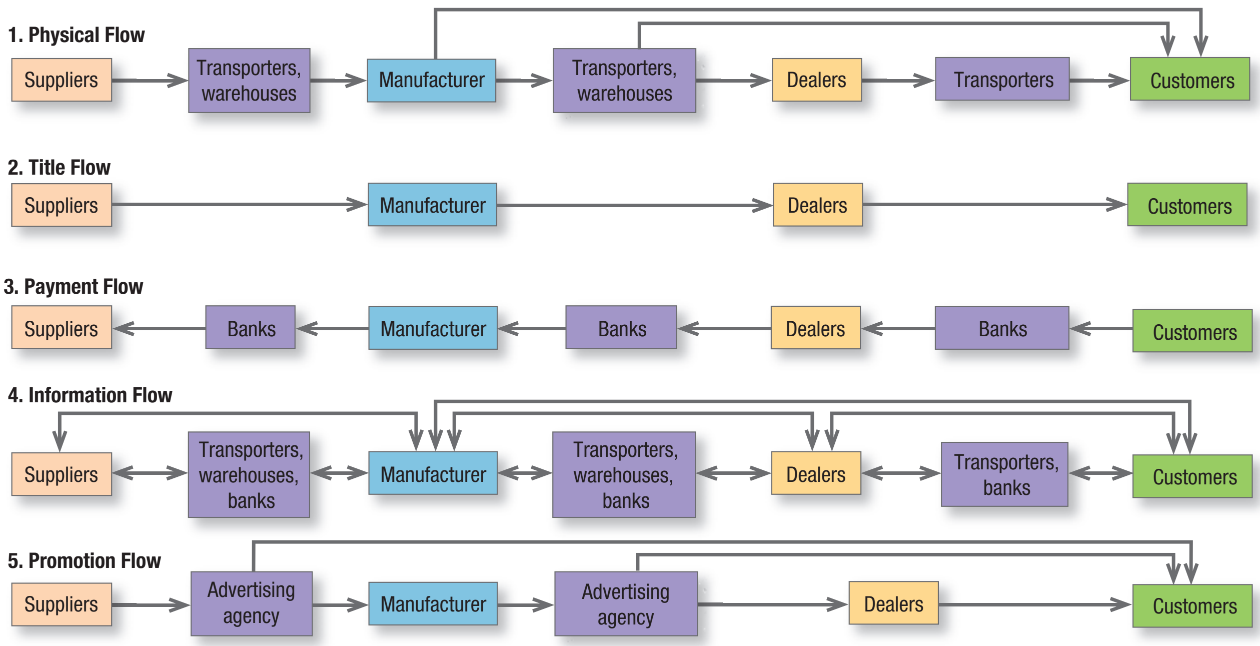
- Gather information about potential and current customers, competitors, and other actors and forces in the marketing environment.
- Develop and disseminate persuasive communications to stimulate purchasing.
- Negotiate and reach agreements on price and other terms so that transfer of ownership or possession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

Many producers lack the financial resources and expertise to sell directly on their own. The William Wrigley Jr. Company would not find it practical to establish small retail gum shops throughout the world or to sell gum online or by mail order. It is easier to work through the extensive network of privately owned distribution organizations. Even Ford would be hard-pressed to replace all the tasks done by its almost 8,500 dealer outlets worldwide.[26]

CHANNEL FUNCTIONS AND FLOWS

A marketing channel performs the work of moving goods from producers to consumers. It overcomes the time, place, and possession gaps that separate goods and services from those who need or want them. Members of the marketing channel perform a number of key functions (see Table 17.1).

Some of these functions (storage and movement, title, and communications) constitute a *forward flow* of activity from the company to the customer; others (ordering and payment) constitute a *backward flow* from customers to the company. Still others (information, negotiation, finance, and risk taking) occur in both directions. Five flows are illustrated in Figure 17.2 for the marketing of forklift trucks. If these flows were superimposed in one diagram, we would see the tremendous complexity of even simple marketing channels.



| Fig. 17.2 |

Five Marketing Flows in the Marketing Channel for Forklift Trucks

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A manufacturer selling a physical product and services might require three channels: a *sales channel,* a *delivery channel,* and a *service channel.* To sell its Bowflex fitness equipment, the Nautilus Group historically has emphasized direct marketing via television infomercials and ads, inbound/outbound call centers, response mailings, and the Internet as sales channels; UPS ground service as the delivery channel; and local repair people as the service channel. Reflecting shifting consumer buying habits, Nautilus now also sells Bowflex through regional and national retailers such as Sears and Dick's Sporting Goods as well as through online merchants such as Amazon.com.

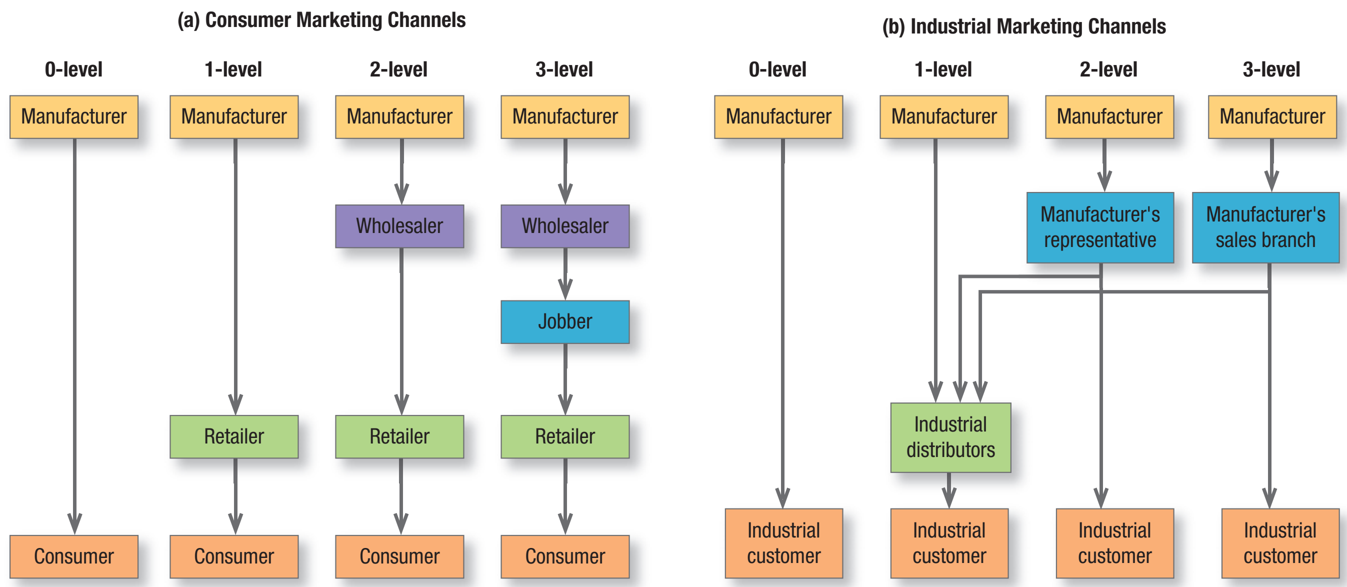
The question for marketers is not *whether* various channel functions need to be performed—they must be—but, rather, *who* is to perform them. All channel functions have three characteristics in common: They use up scarce resources; they can often be performed better through specialization; and they can be shifted among channel members. Shifting some functions to intermediaries lowers the producer's costs and prices, but the intermediary must add a charge to cover its work. If the intermediaries are more efficient than the manufacturer, prices to consumers should be lower. If consumers perform some functions themselves, they should enjoy even lower prices. Changes in channel institutions thus largely reflect the discovery of more efficient ways to combine or separate the economic functions that provide assortments of goods to target customers.

CHANNEL LEVELS

The producer and the final customer are part of every channel. We will use the number of intermediary levels to designate the length of a channel. Figure 17.3(a) illustrates several consumer-goods marketing channels of different lengths.

A **zero-level channel**, also called a **direct marketing channel**, consists of a manufacturer selling directly to the final customer. The major examples are mail order, online selling, TV selling, telemarketing, door-to-door sales, home parties, and manufacturer-owned stores. Traditionally, Franklin Mint sold collectibles through mail order; Red Envelope sold gifts online; Time-Life sold music and video collections through TV commercials or longer "infomercials"; nonprofits and political organizations and candidates use the telephone to raise funds; Avon sales representatives sold cosmetics door to door; Tupperware sold its containers via in-home parties; and Apple sold computers and other consumer electronics through its own stores. Many of these firms now sell directly to customers online and via catalogs. Even traditional consumer-product firms are considering adding direct-to-consumer e-commerce sites to their channel mix. Kimberly-Clark launched an online Kleenex Shop in the United Kingdom.[27]

A *one-level channel* contains one selling intermediary, such as a retailer. A *two-level channel* contains two intermediaries, typically a wholesaler and a retailer, and a *three-level channel* contains three. In the meatpacking industry, wholesalers sell to **jobbers**, essentially small-scale wholesalers, who sell to small retailers. In Japan, food distribution may include as many as six levels. Obtaining information about end users and exercising control become more difficult for the producer as the number of channel levels increases.



| Fig. 17.3 |

Consumer and Industrial Marketing Channels

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Figure 17.3(b) shows channels commonly used in B-to-B marketing. An industrial-goods manufacturer can use its sales force to sell directly to industrial customers, or it can sell to industrial distributors who sell to industrial customers, or it can sell through manufacturer's representatives or its own sales branches directly to industrial customers or indirectly to industrial customers through industrial distributors. Zero-, one-, and two-level marketing channels are quite common.

Channels normally describe a forward movement of products from source to user, but *reverse-flow channels* are also important (1) to reuse products or containers (such as refillable chemical-carrying drums), (2) to refurbish products for resale (such as circuit boards or computers), (3) to recycle products, and (4) to dispose of products and packaging. Reverse-flow intermediaries include manufacturers' redemption centers, community groups, trash-collection specialists, recycling centers, trash-recycling brokers, and central processing warehousing.

SERVICE SECTOR CHANNELS

Many of the most successful new banks, insurance and travel companies, and stock brokerages have emerged with strictly or largely online operations, such as Ally banking, Esurance insurance, Expedia travel, and E*TRADE investments. Marketing channels also keep changing for "person marketing." Besides providing live and programmed entertainment, entertainers, musicians, and other artists can reach prospective and existing fans online in many ways—through their own Web sites, on social community sites such as Facebook and Twitter, and through third-party Web sites. Politicians also must choose a mix of channels—mass media, rallies, coffee hours, spot TV ads, direct mail, billboards, faxes, e-mail, blogs, podcasts, Web sites, and social networking sites—for delivering their messages to voters.

Nonprofit service organizations such as schools develop education-dissemination systems and hospitals develop health-delivery systems. These institutions must figure out agencies and locations for reaching a far-flung population.[28]

CLEVELAND CLINIC One of the largest and most highly respected hospitals in the country, Cleveland Clinic provides medical care in a variety of ways and settings. Its main campus in Cleveland, 50 buildings on 166 acres, is its hub for patient care, research, and education. The clinic also operates 16 full-service Family Health Centers in the suburbs, while eight hospitals extend its reach in Northeast Ohio. Community outreach programs in all these areas provide patient education and free health screenings. Cleveland Clinic also offers major medical care in Florida, Toronto, and manages a Mubadala Development Company medical campus in Abu Dhabi, United Arab Eimireates, scheduled to begin seeing patients in 2015. It has a suite of secure online health services for both patients and physicians and is developing partnerships with Google and Microsoft to extend its online capabilities.

Cleveland Clinic has a comprehensive health-delivery system to provide different kinds of medical care to different markets.

Source: © Philip Scalia/Alamy

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Channel-Design Decisions

To design a marketing channel system, marketers analyze customer needs and wants, establish channel objectives and constraints, and identify and evaluate major channel alternatives.

ANALYZING CUSTOMER NEEDS AND WANTS

Consumers may choose the channels they prefer based on price, product assortment, and convenience as well as their own shopping goals (economic, social, or experiential).[29] Channel segmentation exists, and marketers must be aware that different consumers have different needs during the purchase process.

Even the same consumer, though, may choose different channels for different reasons.[30] As Chapter 16 described, some consumers are willing to "trade up" to retailers offering higher-end goods such as TAG Heuer watches or Callaway golf clubs and "trade down" to discount retailers for private-label paper towels, detergent, or vitamins.[31] Others may browse a catalog before visiting a store or test-drive a car at a dealership before ordering online. "Marketing Insight: Understanding the Showrooming Phenomena" describes some of the new ways customers are using multiple channels as they make their purchases.

Channels produce five service outputs:

1. ***Desired lot size***—The number of units the channel permits a typical customer to purchase on one occasion. In buying cars for its fleet, Hertz prefers a channel from which it can buy a large lot size; a household wants a channel that permits a lot size of one.

marketing **insight**

Understanding the Showrooming Phenomena

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

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

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

Mobile has become a top priority for many retailers as a means to combat showrooming. Target has expanded its use of mobile media, incorporating QR codes, text-to-buy features, and new checkout scanners to make mobile coupon redemption easier and faster. Forty percent of PetSmart's Web traffic comes from smart phones and tablets. eBay observed that 60 percent of e-mails sent by its retail clients were opened on mobile devices and more than half the time were transitioned to other devices to make the transaction.[32]

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

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

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

Sources: "Showrooming Threat Hits Major Chains," www.warc.com, March 1, 2013; "'Showrooming' Grows in U.S.," www.warc.com, February 4, 2013; "Showrooming to Shape U.S. Holiday Sales," www.warc.com, November 16, 2012; Hadley Malcolm, "Smartphones to Play Bigger Role in Shopping," *USA Today*, November 15, 2012; Maribel Lopez, "Can Omni-Channel Retail Combat Showrooming," *Forbes*, October 22, 2012; Australian School of Business, "Stop Customers Treating Your Business as a Showroom," www.smartcompany.com.au, October 8, 2012.

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2. ***Waiting and delivery time***—The average time customers wait for receipt of goods. Customers increasingly prefer faster delivery channels.
3. ***Spatial convenience***—The degree to which the marketing channel makes it easy for customers to purchase the product. Toyota offers greater spatial convenience than Lexus because there are more Toyota dealers, helping customers save on transportation and search costs in buying and repairing an automobile.
4. ***Product variety***—The assortment provided by the marketing channel. Normally, customers prefer a greater assortment because more choices increase the chance of finding what they need, though too many choices can sometimes create a negative effect.[33]
5. ***Service backup***—Add-on services (credit, delivery, installation, repairs) provided by the channel. The more service backup, the greater the benefit provided by the channel.

Providing more service outputs also means increasing channel costs and raising prices. The success of discount stores such as Walmart and Target and extreme examples like Dollar General and Family Dollar indicates that many consumers are willing to accept less service if they can save money.

ESTABLISHING OBJECTIVES AND CONSTRAINTS

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

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

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

In entering new markets, firms often closely observe what other firms are doing. French retailer Auchan considered the presence of its French rivals Leclerc and Casino in Poland as key to its decision to also enter that market.[34] Apple's channel objective of creating a dynamic retail experience for consumers was not being met by existing channels, so it chose to open it own stores.[35]

APPLE STORES When Apple launched its stores in 2001, many questioned their prospects; *BusinessWeek* published an article titled "Sorry Steve, Here's Why Apple Stores Won't Work." Just five years later, the company was celebrating the launch of its spectacular Manhattan showcase. By the end of 2013, it had taken in global sales of $16 billion from more than 400 stores in North America, Europe, and Asia, about 20 percent of total corporate revenue. Roughly 30,000 of Apple's 43,000 U.S. employees work in its stores. Annual sales per square foot were estimated to be $4,406 in 2011—the Fifth Avenue location reportedly earns a staggering $35,000 per square foot–compared with Tiffany's $3,070, Coach's $1,776, and Best Buy's $880. Any way you look at them, Apple Stores have also been an unqualified success in fueling excitement for the brand. They let people see and touch the products—and experience what Apple can do for them—making it more likely they'll become customers. They target tech-savvy customers with in-store product presentations and workshops; a full line of Apple products, software, and accessories; and a "Genius Bar" staffed by specialists who provide technical support, often free of charge. Apple's meticulous attention to detail is reflected in the preloaded music and photos on demo devices, innovative touches such as roving credit-card swipers to minimize checkout lines, and hours invested in employee training. Employees receive no sales commissions and have no sales quotas. They are told their mission is to "help customers solve problems." Although the stores initially upset existing Apple retailers, the company worked hard to smooth relationships, in part justifying its decision as a natural evolution of its online sales channel.

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Source: © Trevor Mogg/Alamy

Although some predicted it would fail, Apple Stores have become an unqualified success both financially and as a brand builder.

IDENTIFYING MAJOR CHANNEL ALTERNATIVES

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

Channel alternatives differ in three ways: the types of intermediaries, the number needed, and the terms and responsibilities of each. Let's look at these factors.

TYPES OF INTERMEDIARIES Consider the channel alternatives identified by a consumer electronics company that produces satellite radios. It could sell its players directly to automobile manufacturers to be installed as original equipment, auto dealers, rental car companies, or satellite radio specialist dealers through a direct sales force or through distributors. It could also sell its players through company stores, online retailers, mail-order catalogs, or mass merchandisers such as Best Buy.

Sometimes a company chooses a new or unconventional channel because of the difficulty, cost, or ineffectiveness of working with the dominant channel. When video rental stores were rapidly declining, Coinstar successfully introduced the Redbox chain of conveniently located DVD- and game-rental kiosks.[36] Netflix is quickly moving away from the revolutionary channel that brought it much success—direct mail—to capitalize on a new one.[37]

NETFLIX Convinced that DVDs were the home video medium of the future, Netflix founder Reed Hastings came up with a new form of rental distribution via mail order in 1997. The company quickly developed strong customer loyalty and positive word of mouth with its modest subscription fees (as low as $9 a month), usually overnight delivery, and extensive library of thousands of movies and television episodes with no late fees. The service also had proprietary software that let customers search for obscure films and discover new ones. To improve the quality of its searches, Netflix sponsored a well-publicized million-dollar contest that drew thousands of entrants; the winning solution was expected to make its recommendation algorithm twice as effective. With new competition from thousands of Redbox rental kiosks and Amazon.com's download services, Netflix began emphasizing streaming videos and instantaneous delivery mechanisms. After an initial misstep, the firm split the two businesses and charges roughly $8 a month each for physical DVDs and for a streaming download plan. It is now the single-largest source of download traffic in North America, making up more than a third of the total, but it still anticipates growth in DVD rentals from its more than 40 million subscribers. Netflix's success has also captured Hollywood's attention. The company's online communities of customers who read and post reviews and feedback can be an important source of fans for films. Netflix is also creating its own award-winning television programming and has moved into international markets in Canada, Europe, and Latin America.

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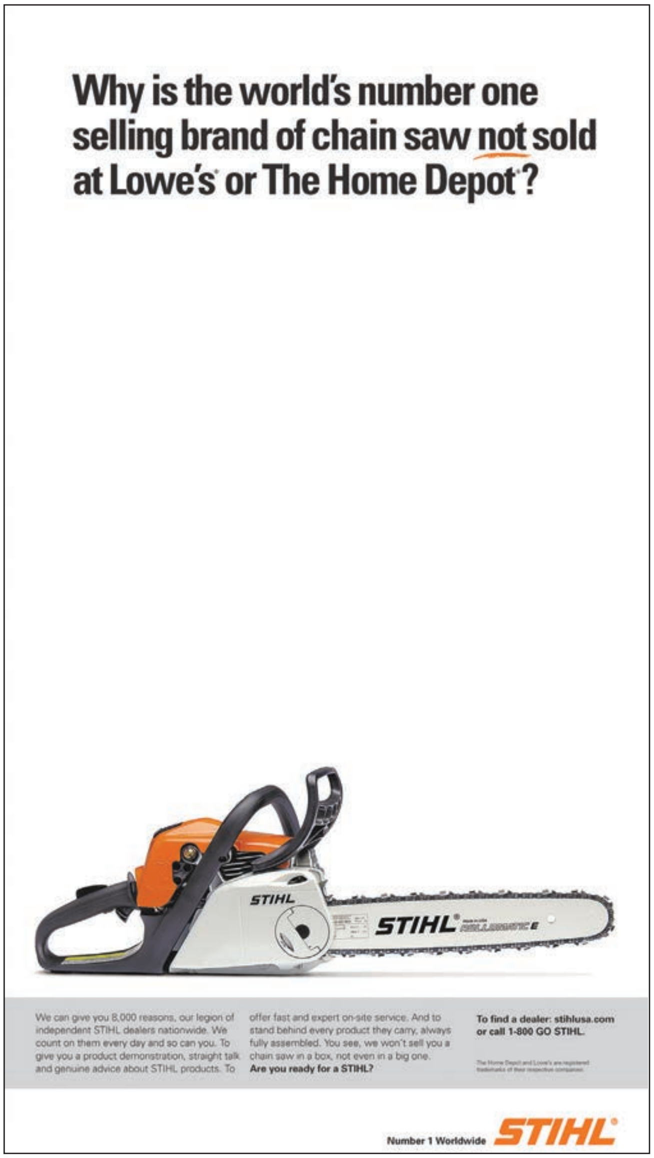
NUMBER OF INTERMEDIARIES Three strategies based on the number of intermediaries are exclusive, selective, and intensive distribution.

Exclusive distribution severely limits the number of intermediaries. It's appropriate when the producer wants to ensure more knowledgeable and dedicated efforts by the resellers, and it often requires a closer partnership with them. Exclusive distribution is used for new automobiles, some major appliances, and some women's apparel brands.

Exclusive distribution often includes *exclusive dealing* arrangements, especially in markets increasingly driven by price. When the legendary Italian designer label Gucci found its image severely tarnished by overexposure from licensing and discount stores, it decided to end contracts with third-party suppliers, control its distribution, and open its own stores to bring back some of the luster.[38]

Selective distribution relies on only some of the intermediaries willing to carry a particular product. Whether established or new, the company does not need to worry about having too many outlets; it can gain adequate market coverage with more control and less cost than intensive distribution. STIHL is a good example of successful selective distribution.[39]

STIHL STIHL manufactures handheld outdoor power equipment. All its products are branded under one name, and it does not make private labels for other companies. Best known for its chain saws, the company has expanded into string trimmers, blowers, hedge trimmers, and cut-off machines. It sells exclusively to six independent U.S. distributors and six company-owned marketing and distribution centers, which sell to a nationwide network of more than 8,000 independent retail dealers offering service. STIHL also exports to 80 countries and is one of the few outdoor-power-equipment companies not selling through mass merchants, catalogs, or the Internet. It even ran an ad campaign called "Why" that touted the strength and support of its independent dealers with headlines such as "Why is the World's No. 1-selling brand of chain saw not sold at Lowe's or The Home Depot?" and "What makes this handblower too powerful to be sold at Lowe's or The Home Depot?"



Source: STIHL Incorporated

Stihl has successfully adopted a selective distribution strategy that bypasses mass merchants, catalogs and the Internet.

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

Manufacturers are constantly tempted to move from exclusive or selective distribution to more intensive distribution to increase coverage and sales. This strategy may help in the short term, but if not done properly, it can hurt long-term performance by encouraging retailers to compete aggressively. Price wars can then erode profitability, dampening retailer interest and harming brand equity. Some firms do not want to be sold everywhere. After Sears acquired discount chain Kmart, Nike pulled all its products from Sears to make sure Kmart could not carry the brand.[40]

TERMS AND RESPONSIBILITIES OF CHANNEL MEMBERS

Each channel member must be treated respectfully and be given the opportunity to be profitable. The main elements in the "trade relations mix" are price policies, conditions of sale, territorial rights, and specific services to be performed by each party.

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- ***Price policy*** calls for the producer to establish a price list and schedule of discounts and allowances that intermediaries see as equitable and sufficient.
- ***Conditions of sale*** refers to payment terms and producer guarantees. Most producers grant cash discounts to distributors for early payment. They might also offer a guarantee against defective merchandise or price declines, creating an incentive to buy larger quantities.
- ***Distributors' territorial rights*** define the distributors' territories and the terms under which the producer will enfranchise other distributors. Distributors normally expect to receive full credit for all sales in their territory, whether or not they did the selling.
- ***Mutual services and responsibilities*** must be carefully spelled out, especially in franchised and exclusive-agency channels. McDonald's provides franchisees with a building, promotional support, a record-keeping system, training, and general administrative and technical assistance. In turn, franchisees are expected to satisfy company standards for the physical facilities, cooperate with new promotional programs, furnish requested information, and buy supplies from specified vendors, as well as pay monthly franchisee fees.

EVALUATING MAJOR CHANNEL ALTERNATIVES

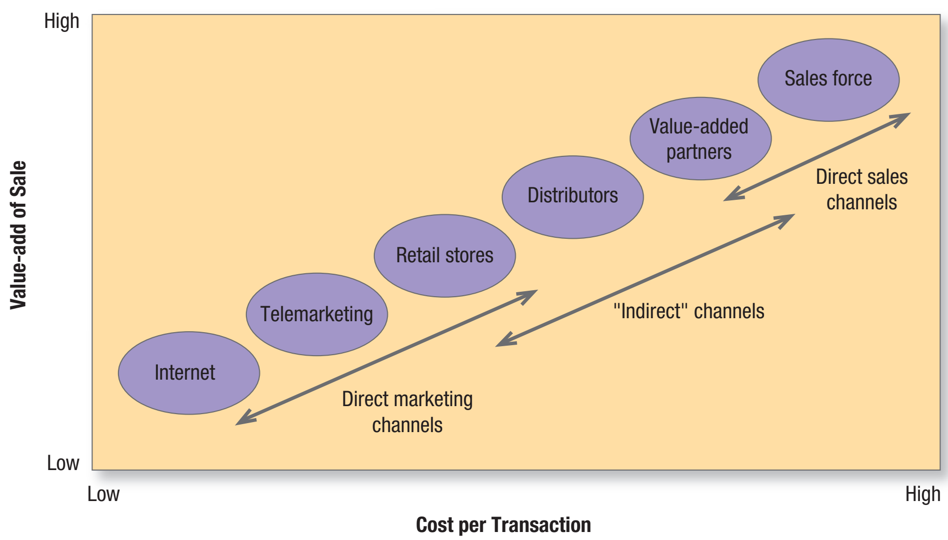
Each channel alternative needs to be evaluated against economic, control, and adaptive criteria.

ECONOMIC CRITERIA Every channel member will produce a different level of sales and costs. Figure 17.4 shows how six different sales channels stack up in terms of the value added per sale and the cost per transaction. For example, in the sale of industrial products costing between $2,000 and $5,000, the cost per transaction has been estimated at $500 (field sales), $200 (distributors), $50 (telesales), and $10 (Internet). A Booz Allen Hamilton study showed that at one time the average transaction at a full-service branch cost a bank $4.07, a phone transaction $.54, and an ATM transaction $.27, but a typical online transaction cost only $.01.[41]

Clearly, sellers try to replace high-cost channels with low-cost channels as long as the value added per sale is sufficient. Consider the following situation:

> A North Carolina furniture manufacturer wants to sell its line to retailers on the West Coast. One alternative is to hire 10 new sales representatives to operate out of a sales office in San Francisco and receive a base salary plus commissions. The other alternative is to use a San Francisco manufacturer's sales agency that has extensive contacts with retailers. Its 30 sales representatives would receive a commission based on their sales.

The first step is to estimate the dollar volume of sales each alternative will likely generate. A company sales force will concentrate on the company's products, be better trained to sell them, be more aggressive, and be more successful because many customers will prefer to deal directly with the company. The sales agency has 30 representatives, however, not just 10; it may be just as aggressive, depending on the commission level; customers may appreciate its independence; and it may have extensive contacts and market knowledge. The marketer needs to evaluate all these factors in formulating a demand function for the two different channels.



| Fig. 17.4 |

The Value-Adds versus Costs of Different Channels

Source: Oxford Associates, adapted from Dr. Rowland T. Moriarty. Cubex Corp.

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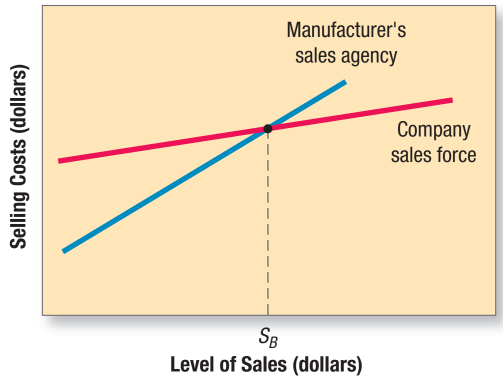
| Fig. 17.5 |

Break-Even Cost Chart for the Choice between a Company Sales Force and a Manufacturer's Sales Agency



The next step is to estimate the costs of selling different volumes through each channel. The cost schedules are shown in Figure 17.5. Engaging a sales agency is less expensive, but costs rise faster because sales agents get larger commissions.

The final step is comparing sales and costs. As Figure 17.5 shows, there is one sales level (S_B) at which selling costs for the two channels are the same. The sales agency is thus the better channel for any sales volume below S_B, and the company sales branch is better at any volume above S_B. Given this information, it is not surprising that sales agents tend to be used by smaller firms or by large firms in smaller territories where the volume is low.

CONTROL AND ADAPTIVE CRITERIA Using a sales agency can pose a control problem. Agents may concentrate on the customers who buy the most, not necessarily those who buy the manufacturer's goods. They might not master the technical details of the company's product or handle its promotion materials effectively.

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

Channel-Management Decisions

After a company has chosen a channel system, it must select, train, motivate, and evaluate intermediaries for each channel. It must also modify channel design and arrangements over time, including the possibility of expansion into international markets.

SELECTING CHANNEL MEMBERS

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

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

TRAINING AND MOTIVATING CHANNEL MEMBERS

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

Carefully implemented training, market research, and other capability-building programs can motivate and improve intermediaries' performance. The company must constantly communicate that intermediaries are crucial partners in a joint effort to satisfy end users of the product. Microsoft requires its third-party service engineers

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to complete a set of courses and take certification exams. Those who pass are formally recognized as Microsoft Certified Professionals and can use this designation to promote their own business. Other firms use customer surveys rather than exams.

CHANNEL POWER Producers vary greatly in their skill in managing distributors. **Channel power** is the ability to alter channel members' behavior so they take actions they would not have taken otherwise.[42] Manufacturers can draw on the following types of power to elicit cooperation:

- ***Coercive power.*** A manufacturer threatens to withdraw a resource or terminate a relationship if intermediaries fail to cooperate. This power can be effective, but its exercise produces resentment and can lead the intermediaries to organize countervailing power.
- ***Reward power.*** The manufacturer offers intermediaries an extra benefit for performing specific acts or functions. Reward power typically produces better results than coercive power, but intermediaries may come to expect a reward every time the manufacturer wants a certain behavior to occur.
- ***Legitimate power.*** The manufacturer requests a behavior that is warranted under the contract. As long as the intermediaries view the manufacturer as a legitimate leader, legitimate power works.
- ***Expert power.*** The manufacturer has special knowledge the intermediaries value. Once the intermediaries acquire this expertise, however, expert power weakens. The manufacturer must continue to develop new expertise so intermediaries will want to continue cooperating.
- ***Referent power.*** The manufacturer is so highly respected that intermediaries are proud to be associated with it. Companies such as IBM, Caterpillar, and Hewlett-Packard have high referent power.[43]

Coercive and reward power are objectively observable; legitimate, expert, and referent power are more subjective and depend on the ability and willingness of parties to recognize them.

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

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

CHANNEL PARTNERSHIPS More sophisticated companies try to forge a long-term partnership with distributors.[44] The manufacturer clearly communicates what it wants from its distributors in the way of market coverage, inventory levels, marketing development, account solicitation, technical advice and services, and marketing information and may introduce a compensation plan for adhering to the policies.

To streamline the supply chain and cut costs, many manufacturers and retailers have adopted *efficient consumer response (ECR) practices* to organize their relationships in three areas: (1) *demand-side management,* or collaborative practices to stimulate consumer demand by promoting joint marketing and sales activities, (2) *supply-side management,* or collaborative practices to optimize supply (with a focus on joint logistics and supply chain activities), and (3) *enablers and integrators*, or collaborative information technology and process improvement tools to support joint activities that reduce operational problems, allow greater standardization, and so on.

Research has shown that although ECR has a positive impact on manufacturers' economic performance and capability development, manufacturers may also feel they are inequitably sharing the burdens of adopting it and not getting as much as they deserve from retailers.[45]

EVALUATING CHANNEL MEMBERS

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

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MODIFYING CHANNEL DESIGN AND ARRANGEMENTS

No channel strategy remains effective over the whole product life cycle. In competitive markets with low entry barriers, the optimal channel structure will inevitably change over time. New technologies have created digital channels undreamed of years ago. The change could mean adding or dropping individual market channels or channel members or developing a totally new way to sell goods. When new competition from Best Buy and Costco forced one-third of Leica's U.S. dealers to close, the high-end camera maker decided to open its own stylish stores to appeal to serious photographers.[46]

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

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

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

CHANNEL MODIFICATION DECISIONS

A producer must periodically review and modify its channel design and arrangements.[47] The distribution channel may not work as planned, consumer buying patterns change, the market expands, new competition arises, innovative distribution channels emerge, and the product moves into later stages in the product life cycle.[48]

To add or drop individual channel members, the company needs to make an incremental analysis. Customer databases and sophisticated analysis tools can provide guidance.[49] A basic question is: What would the firm's sales and profits look like with and without this intermediary? Perhaps the most difficult decision is whether to revise the overall channel strategy.[50] Avon's door-to-door system for selling cosmetics was modified as more women left the house and entered the paid workforce.

GLOBAL CHANNEL CONSIDERATIONS

International markets pose distinct challenges, including variations in customers' shopping habits and the need to gain social acceptance or legitimacy among others, but opportunities do exist.[51] U.S. retailers such as The Limited and the Gap have become globally prominent. Dutch retailer Ahold and Belgian retailer Delhaize earn almost two-thirds and three-quarters of their sales, respectively, in nondomestic markets. Among foreign-based global retailers in the United States are Italy's Benetton, Sweden's IKEA home furnishings stores, and Japan's UNIQLO casual apparel retailer.

Developing markets have become a target for many retailers. Franchised companies such as Subway sandwich shops have experienced double-digit growth overseas, especially in Brazil and Central and Eastern Europe. In some cases, *master franchisees* pay a significant fee to acquire a territory or country where they operate as "mini-franchisers" in their own right. More knowledgeable about local laws, customs, and consumer needs than foreign companies, they sell and oversee franchises and collect royalties.[52]

In India, sales from "organized retail"—hypermarkets, supermarkets, and department stores—make up only a small percentage of the huge market. As Chapter 8 noted, most shopping still takes place in millions of independent grocery stores or *kirana* shops, which are run by their owners and are popular because they extend credit and deliver even small orders. India's complex regulations, poor infrastructure, and expensive real estate also make it a difficult market for retail chains to enter.[53]

China has similar logistical challenges, though a growing middle class offers opportunity and firms such as Best Buy, Coach, and the Gap are meeting with some success.[54] But many pitfalls exist in global expansion. The world's top three retailers—U.S.-based Walmart, UK-based Tesco, and France-based Carrefour—all have struggled to enter certain overseas markets. Consider the plight of Tesco.[55]

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Source: © TJP/Alamy

Despite much consumer research and a sizable investment, British retailing giant Tesco's entry into the U.S. market, Fresh & Easy neighborhood markets, ultimately failed.

TESCO Tesco introduced its Fresh & Easy gourmet mini-supermarkets into California after much research that included spending time with U.S. families and videotaping the contents of their refrigerators. Fresh & Easy's 200 or so stores were roughly 10,000 square feet, about one-fifth the size of a standard U.S. supermarket but much bigger than a convenience store, with a focus on fresh-food offerings. Yet, after five unprofitable years and more than $1.6 billion in losses, Tesco decided to exit the market in 2013. A host of problems plagued the retailer. Its U.S. customers were unaccustomed to British-style ready meals, self-service cash registers, and unorthodox store layouts. Other complaints were that the product range was too narrow, there was no bakery and an underwhelming flower department, and the stores were physically too cold. The United States was not the only trouble spot for Tesco. The company had exited Japan the preceding year and was finding trouble in Central and Eastern Europe. While it focused on geographical expansion, its core supermarket business in the United Kingdom was neglected. Stores weren't properly staffed, fresh food was not properly maintained, and new private-label products were not introduced. The attempt to add non-grocery items like clothing and electronics proved difficult in a recession, and entry into new areas like banking and telephony was a distraction. After enduring six consecutive quarters of same-store sales declines in its home market, Tesco announced a $1.7 billion program to refresh its UK stores and a pull-back of its global ambitions.

The problems Tesco courted in the United Kingdom are a common downside of overly aggressive global expansion. Selling everything from food to televisions, Carrefour, the world's second-biggest retailer, has also encountered stiff competition at home, from smaller supermarkets for groceries and from specialist retailers such as IKEA for other goods. Although strong in some parts of Europe and Asia, Carrefour (which means "crossroads" in French) has been forced to cease operations in Japan, South Korea, Mexico, Czech Republic, Slovakia, Switzerland, and Portugal.[56]

The first step in global channel planning, as so often in marketing, is to get close to customers. To adapt its clothing lines to European tastes, Philadelphia-based Urban Outfitters set up a separate design and merchandising unit in London before it opened its first store in Europe. Although it increased costs, the distinctive blend of U.S. and European looks helped the retailer stand out, and it was one of the few fashion retailers to build strength during the recent recession.[57]

A good retail strategy that offers customers a positive shopping experience and unique value, if properly adapted, is likely to find success in more than one market. Take Topshop, for instance.[58]

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Urban Outfitters carefully studied the European market to ensure its blend of fashion merchandise would appeal to consumer tastes there.

Source: © Loop Images Ltd/Alamy

TOPSHOP Founded by Sir Richard Green in 1994, British clothing retailer Topshop is a chain of more than 300 UK stores and 130 franchise stores in 37 countries that commands intense loyalty from its trendy, style-obsessed customer base. Selling primarily women's party clothes, accessories, and daywear, the chain blends English street fashion, reasonable prices, and fun services. A higher-end, quirkier version of fast-fashion chains H&M and Zara, it allows middle-market consumers to dress trendily and affordably, in punk-inspired pinafores or ladylike tweed. New products are flown in two to three times a week, and store selections are updated multiple times in a day. Partnering with style icons Kate Moss, Stella Vine, and Celia Birtwell to create the latest designs, Topshop offers style advisors, Topshop-to-Go (a Tupperware-type party that brings a style advisor to a customer's home with outfits for as many as 10 people), and Topshop Express (an express delivery service via Vespa scooters for fashion "emergencies"). The company's Topman chain caters to a male audience. It seeks prime locations for its stores and complements them with an online store. The 60,000-square-foot store on Broadway in New York City is Topshop's second biggest and the first flagship store outside the United Kingdom. It has shop-in-shop locations in Nordstrom department stores throughout the United States and in the Karstadt department store chain in Germany.

Channel Integration and Systems

Distribution channels don't stand still. We'll look at the recent growth of vertical, horizontal, and multichannel marketing systems. After considering some e-commerce and m-commerce issues, we next examine how these systems cooperate, conflict, and compete.

VERTICAL MARKETING SYSTEMS

A **conventional marketing channel** consists of an independent producer, wholesaler(s), and retailer(s). Each is a separate business seeking to maximize its own profits, even if this goal reduces profit for the system as a whole. No channel member has complete or substantial control over other members.

A **vertical marketing system (VMS)**, by contrast, includes the producer, wholesaler(s), and retailer(s) acting as a unified system. One channel member, the *channel captain,* sometimes called a *channel steward*, owns or franchises the others or has so much power that they all cooperate. Stewards accomplish channel coordination without issuing commands or directives by persuading channel partners to act in the best interest of all.[59]

A channel steward might be the maker of the product or service (Procter & Gamble or American Airlines), the maker of a key component (microchip maker Intel), the supplier or assembler (Dell or Arrow Electronics), or the

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distributor (W.W. Grainger) or retailer (Walmart). Within a company, stewardship might rest with the CEO, a top manager, or a team of senior managers.

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

VMSs arose from strong channel members' attempts to control channel behavior and eliminate conflict over independent members pursuing their own objectives. These systems achieve economies through size, bargaining power, and elimination of duplicated services. Business buyers of complex products and systems value the extensive exchange of information they can offer.[60] VMSs have become the dominant mode of distribution in the U.S. consumer marketplace, serving 70 percent to 80 percent of the market. There are three types: corporate, administered, and contractual.

CORPORATE VMS A *corporate VMS* combines successive stages of production and distribution under single ownership. For years, Sears obtained more than half the goods it sells from companies it partly or wholly owned. Sherwin-Williams makes paint but also owns and operates 3,500 retail outlets.

ADMINISTERED VMS An *administered VMS* coordinates successive stages of production and distribution through the size and power of one of the members. Manufacturers of dominant brands can secure strong trade cooperation and support from resellers. Thus, Frito-Lay, Procter & Gamble, and Campbell Soup command high levels of cooperation from their resellers in the matter of displays, shelf space, promotions, and price policies. The most advanced supply-distributor arrangement for administered VMSs relies on **distribution programming**, which builds a planned, professionally managed, vertical marketing system that meets the needs of both manufacturer and distributors.

CONTRACTUAL VMS A *contractual VMS* consists of independent firms at different levels of production and distribution integrating their programs on a contractual basis to obtain more economies or sales impact than they could achieve alone.[61] Sometimes thought of as "value-adding partnerships" (VAPs), contractual VMSs come in three types:

1. ***Wholesaler-sponsored voluntary chains***—Wholesalers organize voluntary chains of independent retailers to help standardize their selling practices and achieve buying economies in competing with large chain organizations.
2. ***Retailer cooperatives***—Retailers take the initiative and organize a new business entity to carry on wholesaling and possibly some production. Members concentrate their purchases through the retailer co-op and plan their advertising jointly, sharing in profits in proportion to their purchases. Nonmember retailers can also buy through the co-op but do not share in the profits.
3. ***Franchise organizations***—A channel member called a *franchisor* might link several successive stages in the production-distribution process. Franchising has been the fastest-growing retailing development in recent years.

Although the basic idea is an old one, some forms of franchising are quite new. The traditional system is the *manufacturer-sponsored retailer franchise.* Ford licenses independent businesspeople to sell its cars who agree to meet specified conditions of sales and services. Another system is the *manufacturer-sponsored wholesaler franchise.* Coca-Cola licenses bottlers (wholesalers) in various markets that buy its syrup concentrate and then carbonate, bottle, and sell it to retailers in local markets. A newer system is the *service-firm-sponsored retailer franchise,* organized by a service firm to bring its service efficiently to consumers. We find examples in auto rental (Hertz and Avis), fast food (McDonald's and Burger King), and the motel business (Howard Johnson and Ramada Inn). In a dual distribution system, firms use both vertical integration (the franchisor actually owns and runs the units) and market governance (the franchisor licenses the units to other franchisees).[62]

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

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HORIZONTAL MARKETING SYSTEMS

Another channel development is the **horizontal marketing system**, in which two or more unrelated companies put together resources or programs to exploit an emerging marketing opportunity. Each company lacks the capital, know-how, production, or marketing resources to venture alone, or it is afraid of the risk. The companies might work together on a temporary or permanent basis or create a joint venture company.

For example, many supermarket chains have arrangements with local banks to offer in-store banking. Citizens Bank has more than 500 branches in supermarkets, making up roughly one-third of its branch network. Citizens's staff members in these locations are more sales oriented, younger, and more likely to have some retail sales background than staff in the traditional brick-and-mortar branches.[63]

E-Commerce Marketing Practices

E-commerce uses a Web site to transact or facilitate the sale of products and services online. Online retail sales have exploded, and it is easy to see why. Online retailers can predictably provide convenient, informative, and personalized experiences for vastly different types of consumers and businesses. By saving the cost of retail floor space, staff, and inventory, they can also profitably sell low-volume products to niche markets.

While consumers often go online to try to find lower prices,[64] online retailers in fact compete in three key aspects of a transaction: (1) customer interaction with the Web site, (2) delivery, and (3) ability to address problems when they occur.[65]

We can distinguish between **pure-click** companies, those that have launched a Web site without any previous existence as a firm, and **brick-and-click** companies, existing companies that have added an online site for information or e-commerce.

PURE-CLICK COMPANIES

There are several kinds of pure-click companies: search engines, Internet service providers (ISPs), commerce sites, transaction sites, content sites, and enabler sites. Commerce sites sell all types of products and services, notably books, music, toys, insurance, stocks, clothes, financial services, and so on. They use various strategies to compete: AutoNation is a leading metamediary of car buying and related services; Hotels.com is the information leader in hotel reservations; Buy.com leads on price.

E-COMMERCE SUCCESS FACTORS Companies must set up and operate their e-commerce Web sites carefully. Customer service is critical. Online shoppers may select an item for purchase but fail to complete the transaction. Worse, only 2 percent to 3 percent of visits to online retailers lead to sales, compared with 5 percent of visits to department stores.[66]

To improve conversion rates, firms should make the Web site fast, simple, and easy to use. Something as simple as enlarging product images on screen can increase perusal time and the amount customers buy.[67] Some of the larger e-commerce firms such as eBay and Amazon are offering same-day delivery in major markets.[68] A good return policy is also crucial.[69] To drive traffic to a site, many firms employ affiliate marketing, paying online content providers to drive business to their brands' sites.[70]

Consumer surveys suggest that the most significant inhibitors of online shopping are the absence of pleasurable experiences, social interaction, and personal consultation with a company representative.[71] Firms have responded. Many now offer live online chat to give potential customers immediate advice about products and suggest additional items. When a representative is active in the sale, the average dollar amount per order is typically higher. B-to-B marketers also need to put a human face on their e-commerce presence, and some are taking advantage of technologies such as virtual environments, blogs, online videos, and click-to-chat.

To increase customer satisfaction and the entertainment and information value of online shopping experiences, some firms are employing *avatars,* animated characters that act as company representatives, personal shopping assistants, Web site guides, or conversation partners. Avatars can enhance the effectiveness of an online sales channel, especially if they are seen as expert or attractive.[72]

Ensuring security and privacy online remains important. Customers must find the Web site trustworthy, even if it represents an already highly credible offline firm. Investments in Web site design and security can help reassure customers sensitive to online risk.[73]

B-TO-B E-COMMERCE Although business-to-consumer (B-to-C) Web sites have attracted much attention in the media, even more activity is being conducted on business-to-business (B-to-B) sites, which are changing the supplier–customer relationship in profound ways.

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In the past, buyers exerted a lot of effort to gather information about worldwide suppliers. B-to-B sites make markets more efficient, giving buyers easy access to a great deal of information from (1) supplier Web sites; (2) *infomediaries,* third parties that add value by aggregating information about alternatives; (3) *market makers,* third parties that link buyers and sellers; and (4) *customer communities*, where buyers can swap stories about suppliers' products and services.[74]

Firms are using B-to-B auction sites, spot exchanges, online product catalogs, barter sites, and other online resources to obtain better prices. Ironically, the largest of the B-to-B market makers is Alibaba, homegrown in China where businesses have faced decades of Communist hostility to private enterprise.[75]

ALIBABA The brainchild of Jack Ma, Alibaba began in 1999 and has grown through the years to become the world's largest online marketplace, allowing people and businesses to buy and sell any type of product—from Fuji apples to Boeing 737s. Its numbers are staggering. The $15 billion company has 500 million registered users on nine platforms in 220 countries and regions and enjoys about 80 percent of the Chinese e-commerce market. On Singles' Day on November 11, 2012—a local twist on Valentine's Day and China's biggest online shopping day—Taoboa (a consumer-to-consumer marketplace) and Tmall (a business-to-consumer marketplace), Alibaba's two main platforms, topped $5.75 billion in sales from 400 million unique visitors in 24 hours. More than 10 million of the 16 million parcels delivered in China each day originate from Taobao and Tmall, so logistics providers are crucial (there are no UPS or FedEx counterparts). A cross between Amazon.com, eBay, Rackspace, and PayPal, Alibaba makes money primarily from commissions and from advertising by buyers and sellers exchanging goods. To establish customer trust, the company set up TrustPass, in which users pay Alibaba a fee to hire a third party that verifies them. Users must have five people vouch for them and provide a list of all their certificates/business licenses. Anyone who has done business with a user is encouraged to comment, in the same way buyers comment on sellers in Amazon.com's or eBay's marketplace. The company is valued at more than $120 billion, making Yahoo's 24 percent stake in it a very wise investment.

The effect of these B-to-B mechanisms is to make prices more transparent. For undifferentiated products, price pressure will increase. For highly differentiated products, buyers will gain a better picture of the items' true value. Suppliers of superior products will be able to offset price transparency with value transparency; suppliers of undifferentiated products will need to drive down their costs in order to compete.

BRICK-AND-CLICK COMPANIES

Although many brick-and-mortar companies once hesitated to open an e-commerce channel for fear of conflict with their channel partners, most have added the Internet after seeing how much business was generated online.[76] Even Procter & Gamble, which used traditional physical channels of distribution exclusively for years, is selling some big brands such as Tide, Pampers, and Olay online via its P&G e-store, in part to be able to examine consumer shopping habits more closely.[77] One study showed that more than a third of Internet users have made purchases directly from brand Web sites.[78]

Managing the online and offline channels has thus become a priority for many firms.[79] There are at least three strategies for trying to gain acceptance from intermediaries. One, offer different brands or products online and offline. Two, offer offline partners higher commissions to cushion the negative impact on sales. Three, take orders on the Web site but have retailers deliver and collect payment. Harley-Davidson decided to tread carefully before going online.[80]

HARLEY-DAVIDSON Given that Harley-Davidson sells more than $1 billion worth of parts and accessories and general merchandise to its loyal followers—generating roughly one-quarter of its annual revenue—an online venture to reach even more customers was an obvious next step. The company needed to be careful, however, to avoid the wrath of its 850 dealers who benefit from high margins on their sales. Its solution was to prompt online customers to select a participating Harley dealer from which to purchase, ensuring that the dealer remains the focal point of the customer experience. Dealers, in turn, agreed to a number of standards, such as checking for orders twice a day and shipping promptly. In-store pickup is also an option, and some products are available only in-store.

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Harley-Davidson made sure to not anger its loyal dealer network when it expanded online distribution for its parts and accessories and general merchandise.

Source: © picturesbyrob/Alamy

M-Commerce Marketing Practices

Mobile channels and media can keep consumers as connected and interacting with a brand as they choose. By mid-2013, more than half of all online U.S. buyers had made a purchase on a mobile device, and m-commerce accounted for more than 11 percent of all e-commerce.[81] Tablets are expected to overtake smart phones for mobile shopping, and one estimate says tablets will make up more than 70 percent of mobile retail sales by 2017.[82]

In some parts of the world, m-commerce is very well established. Asian consumers use their mobile phones as their main computers and benefit from a well-developed mobile infrastructure. Mobile ads are well accepted by consumers and relatively inexpensive for firms. In South Korea, Tesco created virtual subway stores for commuters traveling on Seoul's underground transportation system. Interactive, lifelike store aisles with a wide range of product and brand images were superimposed on walls. Consumers could order products for home delivery by simply snapping photos with their phones.[83]

Millions of Japanese teenagers carry DOCOMO phones available from NTT (Nippon Telephone and Telegraph), the country's largest mobile service provider with an ultra-high-speed LTE network. They can also use their phones to order goods. Each month, subscribers receive a bill from NTT listing the monthly subscriber fee, usage fee, and cost of all m-commerce transactions.[84]

M-commerce is well-established in South Korea where virtual stores have been introduced into underground subway stations.

Source: ASSOCIATED PRESS

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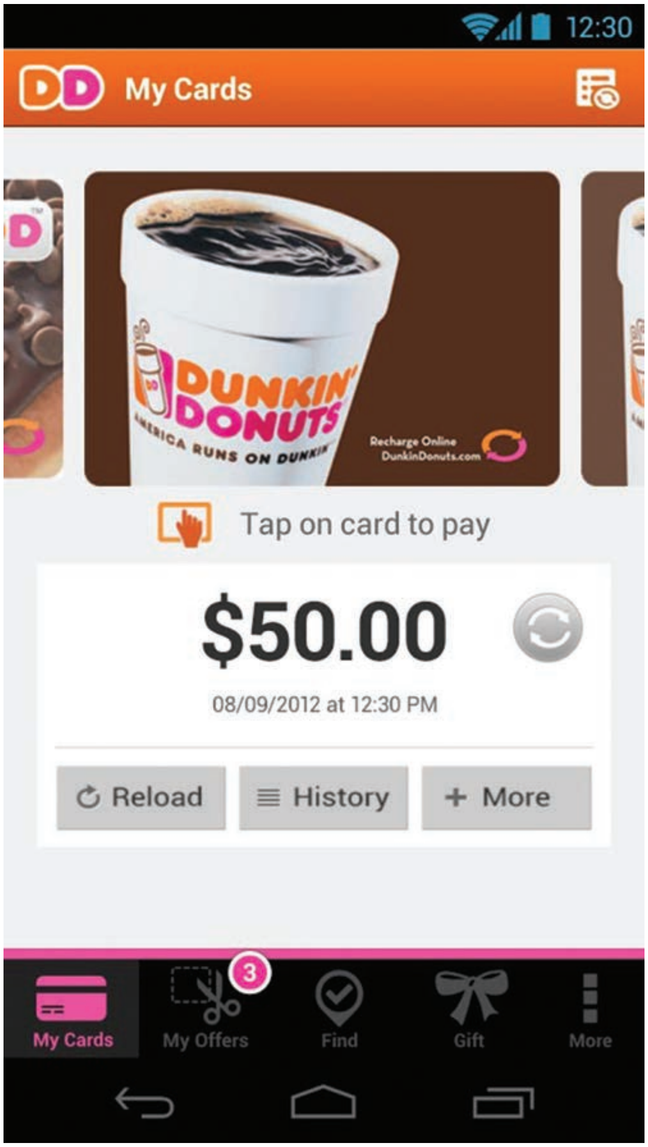
In the United States, mobile marketing is becoming more prevalent and taking all forms. It is easy to understand how entertainment, travel, sporting events, and other time-sensitive categories can benefit from mobile phone apps, but the impact of m-commerce extends far beyond these. Consumers and companies are adapting.[85] Look at Dunkin' Donuts.[86]

DUNKIN' DONUTS An early mobile marketer, Dunkin' Donuts has refined its DD Perks program as part of its corporate goal to lead in digital mobility in the QSR (Quick Serve Restaurant) industry. The DD program was integrated into the company's unified point-of-sales and mobile app to reward loyal customers and encourage them to visit more often and spend more on each visit. The mobile app received 3.5 million downloads in the first year alone. By constructing a purchase history and profile for customers, Dunkin' Donuts can offer more customized and geographically targeted offers that change as customers go from market to market. The app includes a store locator feature and lets customers pay for drinks and meals with a bar code scanned at the point of sale. The company also uses Twitter to run quick, fun promotions and sweepstakes for its on-the-go customers.



Source: Dunkin' Donuts

Dunkin' Donuts is determined to be a market leader in digital mobility for its products and brands.

CHANGES IN CUSTOMER AND COMPANY BEHAVIOR

Consumers are fundamentally changing the way they shop in stores, increasingly using a cell phone to text a friend or relative about a product while shopping in stores. Fifty percent of all Google searches are done on mobile phones.[87] Women may use smart phones more than men in all phases of the shopping experience, making shopping lists and product wish lists, collecting coupons, and sharing photos of their purchases.[88]

Companies are trying to give their customers more control over their shopping experiences by bringing Web technologies into the store, especially via mobile apps. Consider these two examples:

- Although Nordstrom expected its app to be used remotely, many customers launched it while shopping in a store rather than approaching a salesperson. As one executive noted, "A lot of customers like to touch and feel and try on the merchandise, but they also want the information they get online." Nordstrom has added Wi-Fi to almost all its stores, in part so its app will work fast.[89]
- American Express launched its "Link-Like-Love" social commerce program, which sends cardmembers couponless personalized offers from merchants based on their Facebook "likes" and Facebook Places check-ins that are automatically redeemed through card use. Via a partnership with Foursquare, cardmembers could also automatically receive and redeem promotional offers from merchants based on their Foursquare activity.[90]

M-COMMERCE MARKETING PRACTICES

Marketers are using a number of new and traditional practices in m-marketing.

ADVERTISING AND PROMOTION Understanding how consumers want to use their smart phones is critical to understanding the role of advertising. Given the small screen and fleeting attention paid, fulfilling advertising's traditional role of informing and persuading is more challenging for m-commerce marketers. On the plus side, consumers are more engaged and attentive with their smart phones than when they are online.[91] Nevertheless, a number of m-commerce companies are eliminating ads to allow consumers to make purchases with as few clicks as possible.[92]

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Outdoor supplier North Face targets customers with mobile promotions at parks and ski resorts as well as near its stores.

Source: ©nikolpetr/Shutterstock

Promotions are a different story. Consumers often use their smart phones to find deals or capitalize on them: the redemption rate for mobile coupons (10 percent) far exceeds that of paper coupons (1 percent).[93] For retailers, research has shown that mobile promotions can get consumers to travel greater distances within a store and make more unplanned purchases.[94]

GEOFENCING The idea of *geofencing* is to target customers with a mobile promotion when they are within a defined geographical space, typically near or in a store. The local-based service requires just an app and GPS coordinates, but consumers have to opt in. Consider these applications: [95]

- Neiman-Marcus is piloting geofencing in its stores so its salespeople know when their more valuable customers are on the premises and can look at their purchase history to provide more personalized service.
- Outdoor supplier North Face uses geofences around parks and ski resorts in addition to its stores.
- Cosmetics brand retailer Kiehl's uses geofencing around its free-standing stores and kiosks within other stores. It advertises the alerts at its cash register and on social media pages and e-mails list, and it offers customers a free lip balm for enrolling. Thousands have done so, but the company limits it texts to three per month to avoid being intrusive.

PRIVACY

The fact that a company can pinpoint a customer's or employee's location with GPS technology raises privacy issues. Like so many new technologies, such location-based services have potential for good and harm and will ultimately warrant public scrutiny and regulation.

Many consumers are happy to tolerate cookies, profiles, and other online tools that let e-commerce businesses know who they are and when and how they shop, but they are nevertheless concerned when such tracking occurs in the store. When Nordstrom informed customers it was testing new technology to track customers' movements by following the Wi-Fi signals from their smart phones, some consumers objected, leading Nordstrom to drop the experiment.[96]

Conflict, Cooperation, and Competition

No matter how well channels are designed and managed, there will be some conflict, if only because the interests of independent business entities do not always coincide. **Channel conflict** is generated when one channel member's actions prevent another channel member from achieving its goal. Software giant Oracle Corp., plagued by conflict between its high-powered sales force and its vendor partners, has tried a number of solutions, including rolling out new

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"All Partner Territories" where all deals except for specific strategic accounts go through select Oracle partners and allowing partners to secure bigger $1 billion-plus accounts.[97]

Channel coordination occurs when channel members are brought together to advance the goals of the channel instead of their own potentially incompatible goals.[98] Here we examine three questions: What types of conflict arise in channels? What causes conflict? What can marketers do to resolve it?

TYPES OF CONFLICT AND COMPETITION

Suppose a manufacturer sets up a vertical channel consisting of wholesalers and retailers hoping for channel cooperation and greater profits for each member. Yet horizontal, vertical, and multichannel conflict can occur.

- *Horizontal channel conflict* occurs between channel members at the same level. Some Pizza Inn franchisees complained about others cheating on ingredients, providing poor service, and hurting the overall brand image.
- *Vertical channel conflict* occurs between different levels of the channel. When Estée Lauder set up a Web site to sell its Clinique and Bobbi Brown brands, the department store Dayton Hudson reduced the space it gave the company's products.[99] Greater retailer consolidation—the 10 largest U.S. retailers account for more than 80 percent of the average manufacturer's business—has led to increased price pressure and influence from retailers.[100] Walmart, for example, is the principal buyer for many manufacturers, including Disney, Procter & Gamble, and Revlon, and is able to command reduced prices or quantity discounts from these and other suppliers.[101]
- *Multichannel conflict* exists when the manufacturer has established two or more channels that sell to the same market.[102] It's likely to be especially intense when the members of one channel get a lower price (based on larger-volume purchases) or work with a lower margin. When Goodyear began selling its popular tire brands through Sears, Walmart, and Discount Tire, it angered its independent dealers and eventually placated them by offering exclusive tire models not sold in other retail outlets.

CAUSES OF CHANNEL CONFLICT

Some causes of channel conflict are easy to resolve; others are not. Conflict may arise from:

- ***Goal incompatibility.*** The manufacturer may want to achieve rapid market penetration through a low-price policy. Dealers, in contrast, may prefer to work with high margins and pursue short-run profitability.
- ***Unclear roles and rights.*** HP may sell laptops to large accounts through its own sales force, but its licensed dealers may also be trying to sell to large accounts. Territory boundaries and credit for sales often produce conflict.
- ***Differences in perception.*** The manufacturer may be optimistic about the short-term economic outlook and want dealers to carry higher inventory, while the dealers may be pessimistic. In the beverage category, it is not uncommon for disputes to arise between manufacturers and their distributors about the optimal advertising strategy.
- ***Intermediaries' dependence on the manufacturer.*** The fortunes of exclusive dealers, such as auto dealers, are profoundly affected by the manufacturer's product and pricing decisions. This situation creates a high potential for conflict.

MANAGING CHANNEL CONFLICT

Some channel conflict can be constructive and lead to better adaptation to a changing environment, but too much is dysfunctional.[103] The challenge is not to eliminate all conflict, which is impossible, but to manage it better. Verbal reprimands, fines, withheld bonuses, and other remedies can punish a firm in violation and deter others.[104] Table 17.2 lists some mechanisms for effective conflict management that we discuss next.[105]

Strategic Justification In some cases, a convincing strategic justification that they serve distinctive segments and do not compete as much as they might think can reduce potential for conflict among channel members. Developing special versions of products for different channel members—branded variants as described in Chapter 11—is a clear way to demonstrate that distinctiveness.[106]

Dual Compensation Dual compensation pays existing channels for sales made through new channels. When Allstate started selling insurance online, it agreed to pay agents a 2 percent commission for face-to-face service to customers who got their quotes online. Although lower than the agents' typical 10 percent commission for offline transactions, it did reduce tensions.[107]

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TABLE 17.2	Strategies to Manage Channel Conflict
Strategic justification	
Dual compensation	
Superordinate goals	
Employee exchange	
Joint memberships	
Co-optation	
Diplomacy, mediation, or arbitration	
Legal recourse	

Superordinate Goals Channel members can come to an agreement on the fundamental or superordinate goal they are jointly seeking, whether it is survival, market share, high quality, or customer satisfaction. They usually do this best when the channel faces an outside threat, such as a more efficient competing channel, an adverse piece of legislation, or a shift in consumer desires.

Employee Exchange A useful step is to exchange persons between two or more channel levels. GM's executives might agree to work for a short time in some dealerships, and some dealership owners might work in GM's dealer policy department. Thus participants can grow to appreciate each other's point of view.

Joint Memberships Similarly, marketers can encourage joint memberships in trade associations. Good cooperation between the Grocery Manufacturers of America and the Food Marketing Institute, which represents most of the food chains, led to the development of the universal product code (UPC). The associations can consider issues between food manufacturers and retailers and resolve them in an orderly way.

Co-optation **Co-optation** is an effort by one organization to win the support of the leaders of another by including them in advisory councils, boards of directors, and the like. If the organization treats invited leaders seriously and listens to their opinions, co-optation can reduce conflict, but the initiator may need to compromise its policies and plans to win outsiders' support.

Diplomacy, Mediation, and Arbitration When conflict is chronic or acute, the parties may need to resort to stronger means. **Diplomacy** takes place when each side sends a person or group to meet with its counterpart to resolve the conflict. **Mediation** relies on a neutral third party skilled in conciliating the two parties' interests. In **arbitration**, two parties agree to present their arguments to one or more arbitrators and accept their decision.

Sometimes channel conflicts have to be settled by legal recourse as with Coca-Cola and its dispute with Walmart over Powerade.

Source: Getty Images News

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Legal Recourse If nothing else proves effective, a channel partner may choose to file a lawsuit.[108] When Coca-Cola decided to distribute Powerade thirst quencher directly to Walmart's regional warehouses, 60 bottlers complained the practice would undermine their core direct-store-distribution (DSD) duties and filed suit. A settlement allowed for the mutual exploration of new service and distribution systems to supplement the DSD system.[109]

DILUTION AND CANNIBALIZATION

Marketers must be careful not to dilute their brands through inappropriate channels, particularly luxury brands whose images often rest on exclusivity and personalized service. Calvin Klein and Tommy Hilfiger both took a hit when they sold too many of their products in discount channels.

Given the lengths to which they go to pamper customers in their stores—with doormen, glasses of champagne, and extravagant surroundings—luxury brands have had to work hard to provide a high-quality digital experience. They aren't forgetting their stores, though, and are increasingly blending the two. Gucci partnered with Samsung Electronics to create an immersive in-store experience for its timepieces and jewelry that combines physical and mobile commerce. Stores feature transparent displays that show images on the screen without obscuring the products behind them and a digital shop-in-shop section where customers can use tablet computers to browse.[110] To reach affluent customers who work long hours and have little time to shop, many high-end fashion brands such as Dior, Louis Vuitton, and Fendi have unveiled e-commerce sites for researching items before visiting a store—and a means to combat fakes sold online.

LEGAL AND ETHICAL ISSUES IN CHANNEL RELATIONS

Companies are generally free to develop whatever channel arrangements suit them. The law seeks to prevent only exclusionary tactics that might keep competitors from using a channel. Here we briefly consider the legality of certain practices, including exclusive dealing, exclusive territories, tying agreements, and dealers' rights.

We saw earlier that in *exclusive distribution*, only certain outlets are allowed to carry a seller's products, and that requiring these dealers not to handle competitors' products is called *exclusive dealing*. Both channel partners benefit from exclusive arrangements: The seller obtains more loyal and dependable outlets, and the dealer gets a steady supply of special products and stronger seller support. Exclusive arrangements are legal as long as they do not substantially lessen competition or tend to create a monopoly and as long as both parties enter into them voluntarily.

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

Producers of a strong brand sometimes sell it to dealers only if they will take some or all of the rest of the line. This practice is called *full-line forcing*. Such **tying agreements** are not necessarily illegal, but they do violate U.S. law if they tend to lessen competition substantially.

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

Summary

1. Most producers do not sell their goods directly to final users. Between producers and final users stands one or more marketing channels, a host of marketing intermediaries performing a variety of functions.
2. Marketing channel decisions are among the most critical decisions facing management. The company's chosen channel(s) profoundly affect all other marketing decisions.
3. Companies use intermediaries when they lack the financial resources to carry out direct marketing, when direct marketing is not feasible, and when they can earn more by doing so. The most important functions performed by intermediaries are information, promotion, negotiation, ordering, financing, risk taking, physical possession, payment, and title.

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4. Manufacturers have many alternatives for reaching a market. They can sell direct or use one-, two-, or three-level channels. Deciding which type(s) of channel to use calls for analyzing customer needs, establishing channel objectives, and identifying and evaluating the major alternatives, including the types and numbers of intermediaries involved in the channel.
5. Effective channel management calls for selecting intermediaries and training and motivating them. The goal is to build a long-term partnership that will be profitable for all channel members.
6. Marketing channels are characterized by continuous and sometimes dramatic change. Three of the most important trends are the growth of vertical marketing systems, horizontal marketing systems, and multichannel marketing systems.
7. E-commerce has become firmly established as more companies have adopted "brick-and-click" channel systems. M-commerce (selling via smart phones and tablets) is also gaining in importance. Some consumers engage in showrooming by which they shop in stores to inspect products but buy online later to seek a lower price.
8. Channel integration must recognize the distinctive strengths of online, offline, and mobile selling and maximize their joint contributions.
9. All marketing channels have the potential for conflict and competition resulting from goal incompatibility, poorly defined roles and rights, perceptual differences, and interdependent relationships. Companies can try to manage conflict through dual compensation, superordinate goals, employee exchange, co-optation, and other means.
10. Channel arrangements are up to the company, but certain legal and ethical issues to be considered include exclusive dealing or territories, tying agreements, and dealers' rights.

MyMarketingLab

Go to **mymktlab.com** to complete the problems marked with this icon ✪ as well as for additional Assisted-graded writing questions.

Applications

Marketing Debate

Does It Matter Where You Sell?

Some marketers feel that the image of the particular channel in which they sell their products does not matter—all that matters is that the right customers shop there and the product is displayed in the right way. Others maintain that channel images—such as a retail store—can be critical and must be consistent with the image of the product.

Take a position: Channel images do not much affect the brand images of the products they sell *versus* Channel images must be consistent with the brand image.

Marketing Discussion

Channel Integration

✪ Think of your favorite retailers. How have they integrated their channel system? How would you like their channels to be integrated? Do you use multiple channels from them? Why?

Marketing Excellence

>> Amazon.com

Founded by Jeff Bezos in 1995, Amazon.com started as the "world's largest bookstore" and, ironically, owned no books. Bezos promised to revolutionize retailing, however, and over the years he has blazed a trail of e-commerce innovations that many executives have studied and companies have followed.

Amazon initially set out to create personalized storefronts for each customer by providing more useful information and more choices than found in a neighborhood bookstore. Readers could review books and evaluate them on a one- to five-star rating scale, while fellow browsers could rate the reviews for helpfulness. The

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company's personal recommendation service aggregated buying-pattern data to infer who might like which book. Amazon also introduced its revolutionary one-click shopping, which allowed buyers to make purchases effortlessly with a single click.

Amazon started to diversify its product line in the late 1990s, first with DVDs and videos and then with consumer electronics, games, toys, software, video games, and gifts. The company continued to expand its product offerings and in 2007 launched Amazon Video On Demand, allowing consumers to rent or purchase films and television shows to watch on their computers or televisions. Later that year, it introduced Amazon MP3, which competed directly with Apple's iTunes and had participation from all the major music labels.

Amazon's most successful product launch was the Kindle, its branded electronic book reader that delivered hundreds of thousands of books, magazines, blogs, and newspapers in a matter of seconds. As thin as a magazine and light as a paperback, the device has been the company's best-selling product since 2009. Today, you can find virtually anything you want on Amazon.com. The company has successfully established itself as the biggest online retailer in the world by enabling merchants of all kinds to sell items on the site.

In addition to its core business, Amazon also runs an "Associates" program that allows independent sellers and businesses to receive commissions for referring customers to the site in a variety of ways, including direct links and banner ads as well as Amazon Widgets, mini-applications that feature the company's wide selection of products. Associates can create an Amazon-operated online store easily, with low risk and no additional cost or programming knowledge. Fulfillment by Amazon (FBA) takes care of picking, packing, and shipping the merchant's products to its customers.

One consistent key to Amazon's success is its willingness to invest in the latest technology to make shopping online faster, easier, and more personally rewarding for its customers and third-party merchants. During peak season in 2012, the company sold approximately 306 items per second, or 26 million items per day. Small wonder that it continually looks for ways to improve delivery. For a $99 annual fee, Amazon Prime provides unlimited free express shipping for millions of items. While free shipping and price cuts are sometimes unpopular with investors, Bezos believes they build customer satisfaction, loyalty, and frequency of purchase orders.

In 2013, Amazon.com announced a partnership with the U.S. Postal Service to begin delivering orders on Sundays. Bezos also predicted on *60 Minutes* that the company may use drones in the near future to make same-day delivery of lightweight products within short distances of distribution warehouses. (Critics find this unlikely for many reasons, though.)

Amazon has also maintained competitive and low prices throughout its product expansion. The company understands how important it is to keep its prices low in order to drive the volume it needs to remain a market leader and expand geographically. Amazon's practice of selling books at heavily discounted prices, however, has upset some of its channel partners in publishing, as have its attempts to become a publisher in its own right.

From the beginning, Bezos has said that even though he started an online bookstore, he eventually wanted to sell *everything to everyone* through Amazon.com. The company continues to invest significantly in technology, is focused on the long term, and has successfully positioned itself as a technology company with its wide range of Amazon Web Services. This growing collection of infrastructure applications meets the retailing needs of companies of virtually all sizes. Amazon has successfully reinvented itself time and again and created a critical channel for merchants around the world who are able to reach more than 244 million customers worldwide.

Questions

1. Why has Amazon succeeded online when so many other companies have failed?
2. Will the Kindle revolutionize the book industry? Why or why not?
3. What's next for Amazon? Where else can it grow?

Sources: "Click to Download," *Economist,* August 19, 2006, pp. 57–58; Robert D. Hof, "Jeff Bezos' Risky Bet," *BusinessWeek,* November 13, 2006; Erick Schonfield, "The Great Giveaway," *Business 2.0,* April 2005, pp. 80–86; Elizabeth West, "Who's Next?," *Potentials,* February 2004, pp. 7–8; Robert D. Hof, "The Wizard of Web Retailing," *BusinessWeek,* December 20, 2004, p. 18; Chris Taylor, "Smart Library," *Time,* November 17, 2003, p. 68; Deborah Solomon, "Questions for Jeffrey P. Bezos," *New York Times,* December 2, 2009; Patrick Seitz, "Amazon.com Whiz Jeff Bezos Keeps Kindling Hot Concepts," *Investors' Daily Business*, December 31, 2009; Alistair Barr, "Amazon Starts Sunday Delivery with U.S. Postal Service," *USA Today,* November 25, 2013; Adam Lashinsky, "Amazon's Jeff Bezos: The Ultimate Disrupter," *Fortune,* November 16, 2012; Michael Wolf, "Here's Why Amazon Drone Package Delivery May Never Happen," *Forbes,* December 2, 2013; Holman Jenkins Jr., "Jeff Bezos's Mysterious Amazon," *Wall Street Journal,* December 6, 2013; "Amazon's Jeff Bezos Looks to the Future," *60 Minutes*, CBS.com, December 1, 2013; Amazon 2012 Annual Report; George Parker, "Cheap Words," *New Yorker*, February 17, 2014.

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Marketing Excellence

>> Tesco

Tesco's main purpose is to earn a customer's lifetime loyalty by creating value. To achieve this goal, the company has adopted the values of understanding customers, being the first to meet their needs, and acting responsibly in the communities they serve.

Tesco was founded in 1919 by Jack Kohen, who began to sell surplus groceries from a stall in London's East End. On his first day, Kohen had sales of roughly $6.40 and a profit of $1.60. In fiscal year 2014, Tesco Group had sales of $111 billion, with a profit before taxes of $4.78 billion and sales growth of around 1 percent. The firm employs more than 597,784 people and occupies 41 million square feet of selling space in 12 countries.

Tesco's success comes from years of building customer loyalty through merchandising and pricing strategy. Over the years, the company has expanded its range of products and services from simple grocery items to almost everything, including PCs and peripherals, cameras, phones, home electrical appliances, televisions, AV equipment, furniture, kitchen appliances, and home furnishings, so customers can buy everything under one roof. Tesco also offers services that include petrol stations, opticians, and pharmacies.

Tesco started expanding overseas in 1995, starting with Hungary, and now has a presence in China, the Czech Republic, Hungary, India, Japan, Malaysia, Poland, Ireland, Slovakia, Thailand, and Turkey. In the United States, it operates under the name Fresh & Easy Neighborhood Market.

In trying to understand its customers based on their total spending, Tesco found that the top 100 customers were worth the same as the bottom 4,000. The bottom 25 percent of customers represented only 2 percent of sales, whereas the top 5 percent accounted for 20 percent. This showed the firm that all customers are not equal; as a result, it started to measure its more valuable customers by frequency of purchase and value of expenditure.

Tesco began its customer relationship management program in 1995 by introducing Clubcard, which offered loyal shoppers points on purchases and small rebates. Stores captured valuable information with every swipe of the card and built a powerful customer database that could show what products customers were and were not buying, and where they were spending their time in the store (measured by what they spent their money on). Clubcard customers received vouchers for items they specifically liked to buy, rather than general vouchers sent to all customers. Different lifestyle magazines were created for different customers. High-value shoppers received calls from store managers, valet parking when they came to shop, and other privileges so they would feel special and continue to be loyal to Tesco. Tesco now has more than 16 million cardholders and sends about 8 million unique coupon variations with each Clubcard mailing, to ensure that everybody who gets an offer receives an appropriate one. The Clubcard data provides Tesco with detailed information about customers' purchasing behavior. In addition to this data, the company polls around 12,000 customers in their annual Customer Question Time. They receive more direct feedback on products, price, quality, service, and the company's role within the community.

Stores are designed based on consumers' needs. The smallest floor plan, called 'Express', is less than 600 square feet and sells only grocery and food items; the largest 'Home Plus' stores are more than 50,000 square feet in size and sell only non-food items. In 1999, Tesco opened its online store and online banking initiatives. In 2000, it opened Tesco.com. Tesco Direct, another online initiative, sells over 12,500 nonfood products, guaranteeing next-day delivery for store pickup. It is also experimenting with "drive-thru" supermarket service for customers who order through Tesco Direct and can pick up the items within a two-hour block at designated parking spots without getting out of their cars.

In 2009, Tesco branched out to the iPhone by launching three different applications. The first allowed customers to scan their Clubcards using the iPhone's camera, so they didn't have to carry the card on a shopping trip. The second was a Storefinder that allowed customers to find a nearby Tesco outlet. The third, a wine application, allowed customers to take a photograph of a wine they liked, so that they could read product information and place an order using the phone.

In 2010, Tesco created a new mobile Web site to facilitate easy shopping for non-food and household items using smart phones. This followed the launch of a grocery application that allowed barcode scanning by the iPhone. Using the mobile Web site, customers can now conveniently search and buy everything, from televisions to tables to toys. This initiative is part of a commitment to make Tesco available to everyone, anywhere, at any time—whether through the catalog, in-store, online, or by phone.

Tesco also concentrates on providing efficient service. Under its "one-in-front" plan, for instance, if there is more than one customer at a single checkout counter, another counter will be opened. A number of self-service

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checkouts are also available in all stores. With improved CRM and service, Tesco has become a leading supermarket in the United Kingdom and is now expanding to other parts of the world.

Questions

1. As Tesco expands overseas, can it succeed by using the same strategies it has used in the United Kingdom? Why or why not? What factors should it take into account while formulating strategies in global markets?
2. What are the ways in which Tesco connects with its customers to provide more value for them?

Sources: "Tesco—The brand experience is everything," Branding Asia, www.brandingasia.com/cases/tesco.htm; Tesco, www.tescoplc.com.

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In This Chapter, We Will Address the Following **Questions**

1. What major types of marketing intermediaries occupy this sector? (p. 549)
2. What major changes are occurring in the modern retail marketing environment with respect to competitive market structure and technology? (p. 554)
3. What marketing decisions do marketing intermediaries make? (p. 557)
4. What does the future hold for private label brands? (p. 563)
5. What are some of the important issues in wholesaling? (p. 565)
6. What are some important issues in logistics? (p. 567)

With an unconventional marketing strategy blending fashion, value, customer experience, and social responsibility, Warby Parker has made a splash in the staid eyewear category.

Source: Courtesy of Warby Parker. Photgrapher: Collin Hughes.

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