Distribution Policy

The delivery of a good from its manufacturer to its user often involves other parties as well. For example, in buying a textbook, we typically buy from an independent bookstore (such as the college bookstore), not the publisher. Different manufacturers have made fundamentally different decisions on channels. For example:

- Avon sells through its own sales force directly to individual consumers in their own homes.
- Tupperware sells directly to end consumers but with a "party plan" approach.
- General Motors Corporation sells cars to franchised dealers, who in turn sell to consumers.
- Clairol sells its small appliances, such as hair dryers and makeup mirrors, to wholesalers, who then sell to retail outlets.

Thus, some manufacturers sell direct to consumers (Avon, Tupperware), others involve one intermediary (General Motors), and still others, two or more (Clairol). While these examples are all of consumer goods, the same is true for industrial goods.

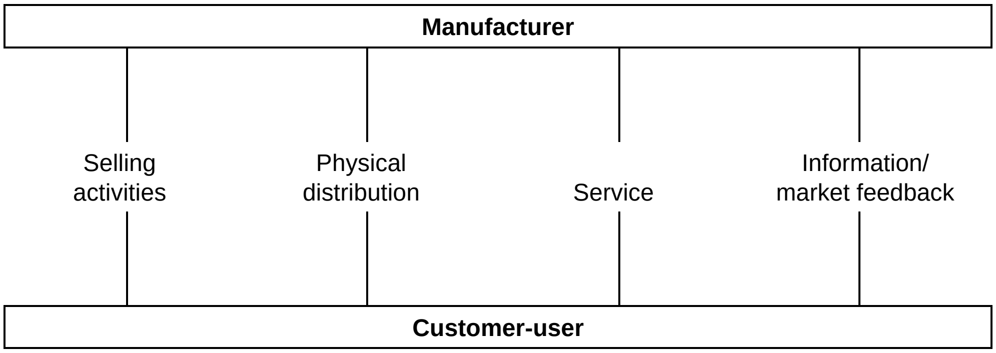
Why do these "middlemen" exist? How many intermediaries should there be at each level; e.g., how many franchised dealers should General Motors have? How can the manufacturer make the other members of the channel do what it wants them to do? These are the questions we take up in this note. First, the "Key Decisions" section examines the channel design questions more closely. Then the "Factors Influencing Optimal Design" section describes the characteristics of manufacturers and markets influencing channel design. Finally, the "Channel Conflict and Control" section considers issues in managing the existing channel to achieve objectives while reducing conflict.

Key Decisions

Figure A shows the set of activities linking a manufacturer and a customer-user.

Professor Robert J. Dolan prepared this note as the basis for class discussion.

Figure A



An efficient system provides for the following:

- Selling activities: These can include providing information to the consumer through advertising, point-of-purchase displays, and personal selling.

- Physical distribution: The goods must be transferred from the place where they are manufactured to the place where the consumer can conveniently buy them.

- Service: For some products, e.g., home computers and many industrial goods, after-the-sale service must be provided.

- Information / market feedback: To be effective in the long run, the manufacturer must have information from the marketplace. Detailed information on consumer reaction to certain attributes, acceptance of the product by specific classes of customer, etc., is required as input to the tailoring of the marketing program.

The channel design decision begins with the question “What needs to be done to get my product sold?” Suppose a watch manufacturer has decided to compete in the mass market in the $15 price range. What specific tasks must be accomplished?

Success in this type of market requires that the firm have

1. An established brand name
2. Distribution in a large number of convenient outlets
3. Good display in those outlets
4. An efficient means of restocking retail outlets

Due to the low-price positioning of the product, knowledgeable personal selling at the point of purchase is not necessary or feasible. After-the-sale service is not a major issue. Note how different the tasks would be if one were selling at the Rolex level ($300 and up) rather than the Timex level. At high-price points, personal selling at the point of purchase becomes crucial.

Once the tasks to be accomplished have been specified, the next question is, “Who is to do each task?” That is, should the company perform the function or delegate it to an intermediary? This is a question of “channel length.” For example, consider the good display in a large number of outlets for the $15 watch. Theoretically, the manufacturer can perform this function by opening a large number of watch stores. However, existing retailer outlets, such as department stores and drugstores, evidently accomplish this task more efficiently than the manufacturer since we do not see Timex watch stores in major U.S. cities.

In general, a task will be the responsibility of one of the following:

1. Manufacturer

2. Manufacturers' representative: A "rep" generally works with the manufacturer on a long-term basis. The rep is not an employee of the manufacturer but is usually granted exclusive territorial rights and paid on a commission basis (i.e., as a percentage of the manufacturer's sales he or she generates). The rep may sell noncompeting products. He or she does not take title to the goods and, consequently, has very limited authority on pricing and terms of sale.

3. Merchant middlemen: The key feature distinguishing these intermediaries from manufacturers' reps is that merchant middlemen buy and take title to the merchandise. They then resell the merchandise under the terms they desire, the manufacturer having given up control of the product with the sale to the merchant middleman. The most common merchant middlemen are

   – Wholesalers (sometimes called distributors), who resell to other merchants (e.g., retailers) or industrial users

   – Retailers, who resell to consumers

The rule on who should perform what functions is very simple: the most efficient organization for the task should do it.

Despite some popular notions to the contrary (best exemplified in advertisements such as "we've eliminated the middleman and passed the savings on to you!"), intermediaries exist because they make the marketing system more efficient. If the manufacturer can perform a task more efficiently, the manufacturer should perform it. Tasks are delegated only when there is an economic reason to do so. In the next section, we discuss factors that influence the economics of operating through manufacturers' reps and merchant middlemen.

Along with this "channel length" issue, there is the issue of channel breadth, i.e., how many firms of each type does the manufacturer want to have? The basic alternatives with respect to channel breadth or intensity of market coverage are

1. Exclusive distribution
2. Selective distribution
3. Intensive distribution

In exclusive distribution, the manufacturer establishes only one reseller in each region to carry the product. Yamaha pianos are an example of this policy. Exclusivity is granted by the manufacturer in the hope that it will induce strong selling support by the reseller. The cost is that, with an exclusive policy, the consumer must be willing to seek out the one outlet in his or her area carrying the brand.

The middle ground between exclusivity and seeking the maximum possible coverage is selective distribution. In selective distribution, there is more than one reseller—although a limited number—in each market. Selective distribution is practiced by some clothing manufacturers (such as Perry Ellis, Hathaway shirts, Bally shoes) and is common in video equipment. The purposive limiting of the number of outlets is intended to increase the support the reseller provides the brand over the case of intensive distribution. Having more than one outlet is intended to increase shopping convenience over exclusive distribution.

Finally, many manufacturers try to place their products with as many resellers as possible. For some markets, it is believed that "share of space" (i.e., retail shelf space) equals "share of market," and thus the objective is to be as widely and intensively distributed as possible. Gillette razor blades, Kodak film, and Budweiser beer are examples of intensive distribution at the retail level.

It is sometimes thought that the more outlets the product is in, the better off the manufacturer is. However, since some manufacturers choose exclusivity, this is not generally the case. As suggested above, moving from exclusive to intensive trades off reseller support for easier availability of goods for the consumer. The next section discusses characteristics of the market situation to be considered in deciding if this trade-off is warranted.

Factors Influencing Optimal Design

Summing up the above section, the principal channel design considerations are

1. Channel length
2. Channel breadth

As is usually the case in marketing, an analysis of consumer behavior is the primary input into the resolution of these questions. Consider three examples to illustrate issues in channel breadth.

1. Shaving cream: Shaving cream is a frequent purchase for the majority of adult males. The acquisition of a new can is a routine and unexciting event. Since the buyer most likely thinks shaving creams are not very different from one another in quality or price, the manufacturer must be certain that the product is conveniently available to the prospective purchaser.

2. Television set: A television set is a relatively infrequent purchase of considerably greater expense than shaving cream. When the decision is made to buy a television set, several members of the family get involved—checking *Consumer Reports* and newspaper ads, shopping around, and generally gathering information appropriate to the importance of the decision. Since consumers do shop around rather than just visit the most convenient outlet and buy there, there is no need for the manufacturer to be in every outlet. In fact, being in every outlet would be a mistake if the family relied on the retail clerk for information. Intensive distribution is justified for the shaving cream because the only retail support required is shelf space. However, when strong, point-of-purchase personal selling is required, going beyond selective distribution would jeopardize the required support. Hence, selective distribution is required.

3. Automobile: For some makes, the consumer behavior would be like that just described for television sets. However, for a specialty item, such as a Porsche 944, it is likely that the purchaser has a very strong brand preference even before the acquisition process begins. Thus, convenience of outlet is not a consideration, and the buyer will go just about anywhere to get the brand he or she insists on. Since the car is purchased infrequently and is an extremely important purchase, the buyer can behave this way. In this event, the permissibility of relatively inconvenient outlets indicates exclusive distribution. (Note that some provision may have to be made for less-than- exclusively distributed warranty servicing of the car.)

These three examples illustrate a frequently used categorization of goods used in marketing. Our shaving cream, television, and exotic car represent a "convenience good," a "shopping good," and a "specialty good," respectively.[1] Of course, no item can be definitely classified as any one of these three types for all consumers. However, the following is a useful guideline:

Convenience good	→	Intensive distribution
Shopping good	→	Selective distribution
Specialty good	→	Exclusive distribution

Once the channel breadth issue is decided, the manufacturer can consider who is to provide the coverage. A common first argument in favor of going direct (i.e., manufacturer performing all services) is that it is easier to guide and control one's own employees than it is to motivate independent parties. Second, in the early stages of a product's life, a very knowledgeable sales presentation may be required because of the educational needs of the consumer. Generally, a manufacturer's employee specializing in selling that manufacturer's products will be more knowledgeable than a distributor selling many products. Selling direct is important in many industrial settings because buyers value a direct relationship with the company to ensure good service and supply in times of a shortage.

With respect to utilizing intermediaries, the first argument is usually that the sales volume of the product does not justify direct selling. In direct selling, the manufacturer performs all required activities, and hence, this is the most expensive form. This cost is seldom justified if the good is a convenience good and the customer base is geographically dispersed.

As with channel breadth, consumer behavior has a direct impact on the channel length issue. For example, consumers wanting quick delivery (necessitating the maintenance of local inventories), one-stop shopping (i.e., being able to buy a variety of products at one outlet), or valuing an association with a local firm to whom their business is important all indicate the use of middlemen rather than direct distribution.

Thus, as in most marketing decisions, both company and customer issues affect the channel design decision. Competitive considerations can have an influence as well. For example, in the home computer market, firms have been forced to seek "unconventional" modes of distribution because the traditional channels were already "clogged" with competitive makes. The distribution channel can be an effective means of product differentiation. For example, L'eggs pantyhose opened up new channels in supermarkets and designed an efficient system for delivery. By moving into grocery stores, L'eggs effectively made pantyhose purchasing a convenience purchase for many women.

Channel Conflict and Control

Once the manufacturer delegates a task to a middleman, an inevitable pattern of conflict and cooperation begins. The manufacturer and the middleman cooperate because their joint efforts produce the sales of the product. However, there is conflict because each wishes the other would do more to stimulate sales. For example, having sold the product to a merchant middleman at a given price, the manufacturer would like low retail prices to stimulate sales. For its part, the retailer would like a higher price than that which maximizes profits for the channel. And, similarly, the downstream firms wish the manufacturer would do more to stimulate sales, e.g., through national advertising.

In order to try to maximize the coordination and reduce the conflict, some relationships between manufacturers and middlemen are spelled out in contracts. These franchise agreements (e.g., McDonald's Dunkin' Donuts, most gas stations, and automobile dealers) bind the parties to

[1]For details, see R.H. Holten, "The Distinction Between Convenience Goods, Shopping Goods, and Specialty Goods," *Journal of Marketing*, July 1958; and L.P. Bucklin, "Retail Strategy and the Classification of Consumer Goods," *Journal of Marketing*, January 1963.

perform certain activities, rather than to seek their own profit maximization. These systems are sometimes called "contractual systems," as opposed to "conventional systems," in which parties operate independently.

Ethical Issues in Distribution Policy

Because channel management requires balancing the interests of manufacturers, middlemen, and customers, there are numerous situations when ethical issues may arise.

One class of situations involves ensuring fair dealings between manufacturers and distribution channels when one side has considerably greater bargaining power than the other. For example, a manufacturer with an extremely popular product line might be tempted to squeeze the channel's profit margins by encouraging competition among retailers to drive retail prices down and stimulate demand, while not lowering its own price to the trade. The channel then bears a disproportionate share of costs, and the manufacturer reaps a disproportionate share of the benefits. While not illegal, the manufacturer's behavior might be questionable on ethical grounds if the manufacturer drives the channel into a loss situation. The balance of power is sometimes reversed, with a critical channel member exerting extreme pressure on a manufacturer's profits through aggressive bargaining. This is not to say that tough price negotiations are unethical. However, there are times when hard bargaining tactics can be carried to an unethical extreme.

A second class of situations involves relations with international distribution channels that may be following ethical and legal standards different from those of the manufacturer. For example, the U.S. Foreign Corrupt Practices Act forbids payment of bribes or other inducements to facilitate sales in other countries, while the laws of the land in many countries do not prohibit such payments. A U.S. manufacturer may then be caught in a dilemma. If it refuses to make the side payment, it will obtain no business. If it makes the payment directly, it violates the U.S. law. Some manufacturers respond to this dilemma by selling their products to the foreign country's local distributors, who do whatever is necessary (including making side payments that are legal in their country but illegal in the United States) to make the sale. Others refuse to do business in the country, thereby forgoing revenues and profits. Is the former practice ethical? Is the latter practice too provincial, expecting the rest of the world to follow one country's standards?

The above examples are just two among many ethical problems that arise in channel management. The questions below should help a marketer to identify when an ethical issue may be involved in a distribution decision:

- Is either the manufacturer or the distributor abusing its power, taking unfair advantage of the other partner?

- Has the manufacturer unwittingly put distribution incentive systems in place that encourage the channel members to engage in unethical practices toward end customers?

- Are distributors using the good name of the manufacturer to persuade customers to do things that are not in their best interests?

- Has the manufacturer tried to insure that distributors provide the education and point-of-purchase communication necessary to insure safe use of its products?

Ethical issues inevitably arise when multiple parties are involved in marketing exchanges. In many instances, the interests of manufacturer, wholesaler, and retailer may be in conflict. However, the marketing concept provides common ground for channel members to discuss their differences. According to Theodore Levitt, the purpose of marketing for all channel members is "satisfying the needs of the customer by means of the product and the whole cluster of things associated with creating, delivering, and finally consuming it."[2] A corollary of the marketing concept is that each organization in the marketing chain is entitled to a reasonable profit in exchange for its contribution to consumer value. With this in mind, the practices of each member of the distribution channel from manufacturer to retailer can be examined to see if each creates value for customers, and to see if the rewards for delivering that value among channel members are allocated fairly.

Summary

Channel management involves a complex web of personal, economic, and legal relationships. As such, the channel decision, once implemented, is the most difficult to change in marketing. For example, it is much easier to cut the advertising budget in half than it is to drop half the firm's retailers if it is decided to shift from intensive to selective distribution. Managing change presents a challenge. We argued above that the optimal channel design was dependent upon consumers (e.g., their familiarity with the good, need for technical service, etc.), company resources, and competition. These factors all change over time. Consequently, the optimal channel design also changes over time. Given the high cost of change, marketing system design must not only consider current market conditions but also anticipate future changes in the marketplace.

[2]Levitt, Theodore (1960), "Marketing Myopia," *Harvard Business Review*, Reprint #75507, p. 6.