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Designing Channels of Distribution

Introduction

In marketing, *distribution* is the process of getting goods from the producer to the ultimate consumer. Distribution occurs through *channels*, agents that facilitate and encourage consumer purchase, the number and nature of which are determined by the producers. Effective sales require that producers determine and then manage a channel or array of channels with the aim of assembling products, personnel, advertising message, and downstream selling partners that, combined, maximize competitive advantage. Producers may change channels in response to changes in market conditions, technology, or other factors, but ill-advised or poorly implemented changes in channels invariably result in loss of reseller support, disappointing sales, and lower profits.

For many firms, how to *go to market*—how to design a distribution system—is a key strategic marketing decision, with each approach providing a unique set of benefits and costs. Often, the only reasonable option is some combination of third-party resellers in a *multistage* distribution process: a manufacturer sells to a reseller (a wholesaler, who may then sell to retailers) who then sells to consumers.[1] In the business-to-business space, the manufacturer often sells to the end-use consumer through wholesale distribution or, in some instances, through a distributor to a dealer or supply house who then serves the consumer. The existence of this multistage process has often been ignored in simple economic models of firm behavior, but increasingly economists and marketers have examined the extent to which producer/reseller relations and incentives determine how goods and services get to consumers and at what price.

When choosing a particular distribution strategy, a manufacturer must balance three primary considerations: *efficiency* (getting products and services to retailers and consumers at the lowest cost); *effectiveness* (market coverage and quality of services provided); and *control* (ability to determine timing and focus of distribution efforts).[2]

Designing and implementing channels of distribution are among the greatest challenges that a marketing manager faces. How the firm decides to go to market could have a far-reaching effect on all aspects of its business, from segmentation and reaching high-priority customers to defining revenue streams and profitability. Compared to other marketing-mix decisions, channel decisions often take a long time to implement. Company A can change its price schedule almost immediately in response to an e-mail or

[1] Producers, such as manufacturers, employ these third-party resellers rather than selling directly to the consumer for at least three distinct reasons: first, few manufacturers can afford to own their entire distribution system; second, even if they could, it might be an inferior use of their investment capital; and third, resellers that combine the offerings of a number of manufacturers may better serve consumers, leading to overall higher sales. Philip Kotler and Kevin Lane Keller, *Marketing Management,* 12th ed. (Upper Saddle River, NJ: Prentice Hall, 2006), 472–80.

[2] Erin Anderson, George S. Day, and V. Kasturi Rangan, "Strategic Channel Design," *Sloan Management Review* (Summer 1997): 67.

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telephone call; in fact, sales requests for price reductions to meet a competitive situation are usually granted. If company B wishes to add a third-party channel to supplement its current sales force, the decision takes time and cannot be implemented quickly. The strategic implications of adding—or deleting—a channel of distribution are quite complex. This technical note will

- Define a channel of distribution,
- Discuss different forms of channels and their benefits and liabilities,
- Describe the process of designing a channel of distribution,
- Present trends that affect the nature of the relationship between manufacturers and their go-to-market strategies, and
- Discuss issues related to margin structure and branding.

Defining a Channel of Distribution

A *channel of distribution* is a set of interdependent firms that collaborate to make a product or service available for end-use consumption.[3] The *interdependent* part is critical. Channel members must recognize that they cannot act alone and must work together to meet the needs of the end-user customer; if any member thinks of another as dependent, an opportunistic and detrimental self-interest is likely to emerge, and power and conflict could rule the relationship. Although inherent in all channel relationships, conflict tends to be held in check if parties see themselves as interdependent.

Implicit in this definition is that a marketing channel represents a *process* in which certain activities are performed and certain *flows*—movements of goods, materials, money, and information—must occur as products or services that proceed from provider to end user. Such activities as managing inventory, providing assortment, breaking bulk, financing, assuming risk, and others enable the timely, efficient, and effective movement of products and services. The objective of channel management is to identify the combination of channel members that best supports the business strategy, balancing responsiveness to customers with total incurred channel cost while retaining enough control to ensure adequate network cooperation.

Channel Types

There are many different channel types, each serving a function in the larger distribution system. **Table 1** describes some common types and the role each plays; the list is by no means comprehensive but is meant to indicate the range of resellers that can exist. (We are witnessing consolidation in the wholesale trade: many family-owned businesses are purchased by larger regional and/or national companies. You might be able to eliminate the middleman, but you cannot eliminate the functions they perform if you want the channel to behave in an efficient and effective manner.)

[3] Ann Coughlan, E. Anderson, L. Stern, and A. El-Ansary, *Marketing Channels*, 6th ed. (Upper Saddle River, NJ: Prentice Hall, 2001).

Table 1. Types of channels.

Distributors (wholesale distribution)	Businesses that sell to other businesses. They create value through the movement of goods by providing activities such as providing assortment, breaking bulk, financing, and managing inventory. These channel members usually take ownership of the goods.
Master Distributors	These channel intermediaries often sit between the manufacturer and other middlemen and hold inventory of hard-to-get parts. They often will have subdistributors who work with them doing more traditional distribution and logistics functions.
Value-Added Resellers (VARS)	Designers, engineers, or consultants who partner with manufacturers of products that are used in their designs. They typically buy at a discount and then resell the product as part of their solution.
Manufacturer Reps	Independent sales agents who carry different manufacturers' lines of product and serve as a third-party sales force for these firms. They carry multiple lines (often noncompeting) and specialize in different end-user applications. They are usually paid a commission on the sale.
Brokers	These are a form of manufacturer's rep and associated with the retail trade serving less complex products. They will work at the store level merchandising the shelves on behalf of the manufacturer they represent.

The question is not *whether* the function should be performed or not—it must be—but *who* will perform it. Wholesalers serve their suppliers (manufacturers) by making stock available locally, breaking bulk, and providing an assortment of goods to facilitate one-stop shopping. They have local market knowledge, so their sales forces can better serve their customers. Also, they provide inventory for their customers that would otherwise be held by their suppliers or their customers. Wholesalers provide a number of valuable functions for their customers: in addition to inventory handling charges, they provide credit and financing, customer service, and advice and technical support.

What Is the Optimal Distribution System?

"If there is no channel conflict, there is not enough coverage"—this myth reflects the reality of the marketer's struggle to balance coverage and control. For manufacturers that sell through independent, third-party distribution, the question is: How many channel outlets are enough to be assured of sufficient market coverage? To describe the extent to which a market is *covered*—the extent to which a product is available to a selected set of customers—marketers speak of *intensive*, *exclusive*, and *selective* distribution.

Intensive distribution

Intensive distribution describes a strategy whereby the product—often, frequently purchased goods of relatively low price—is widely available to a very large set of customers. The goal is to make the product so ubiquitous in the market that finding and purchasing it requires little effort. The downside to such widespread distribution is that, for the manufacturer, maintaining control over how the product is sold is very difficult.

When designing its distribution strategy, a manufacturer must address the trade-off between coverage and control. Many manufacturers want a high level of coverage for their products, but if a reseller perceives too much competition for a particular product, the reseller's efforts for that product may decline. The reseller will, and should, focus effort on those products with the highest return. Competition in distribution lowers return and, therefore, the rewards for effort. In this sense, it is possible for a product to have too much distribution. Manufacturers often will prefer an appropriate number of focused and motivated resellers to a larger number of unfocused and insufficiently motivated resellers or a smaller number of resellers that are unable to provide sufficient coverage. The right amount of coverage is difficult to anticipate and changes with industry conditions. Manufacturers proceed through a process of matching incentives to resellers and selling effort, often tinkering with the system. Once a successful distribution system evolves, however, manufacturers are understandably careful about implementing significant change.

Exclusive distribution

Exclusive distribution reduces greatly the availability of the product and is associated with one outlet per region or location. Often certain rights are granted in exchange for exclusivity, whereby the manufacturer influences a set of business decisions made by its channel partners. Related to exclusive distribution is *exclusive dealing*, where the seller demands that the reseller sell only his products or noncompeting products, enforceable by sanctions if intermediaries do not comply. There are many benefits that accrue from exclusivity, including:

- Reseller dependence on the supplier, which enables greater control over the reseller's behavior
- The elimination of competitors from these exclusive channels
- Lower transaction costs, given the nature of the relationship
- For suppliers, a greater share of mind and greater commitment from the reseller, since their fortunes are linked.[4]

Through exclusivity, a manufacturer is more likely to gain the commitment of its reseller and to send a signal that the channel partners are united in their view of the marketplace. Such dedication benefits the manufacturer because multisite customers (e.g., national accounts) will have very similar distributor experiences regardless of where in the United States they are located. The manufacturer is assured consistent service, processes, and customer interaction; dedicated resellers provide local market knowledge and intimate customer know-how, reducing costs and preventing surprises. Overlap and redundancy are reduced, and the reseller's ability to harness the power of the channel and of the manufacturer's network makes the customer a number-one priority.

There are two immediate benefits of exclusivity that accrue to the manufacturer:

1. It has committed de facto to making its distribution channel its sole sales channel;
2. It is responsible for the proactive management of its channel. Similar to managing an in-house sales force, the manufacturer can work with the channel to establish sales targets and goals; to support the introduction of new products; and to develop plans for acquiring new segments and customers.

Care must be exercised, however, because many of the business reasons employed for exclusive dealing can be applied to tying contracts, which often can be subject to legal remedies. While both serve to limit competition, tying contracts are viewed in a more negative light and are subject to interpretation put forth in the Sherman Act, the Clayton Act, and the FTC Act. As a general rule, if two products are made to be jointly used and one will not operate properly without the other, it is within the bounds of the law.

[4] Coughlan et al.

Selective distribution

Selective distribution is a more limited form of distribution where the product is less widely distributed than if an intensive strategy is employed but is more available than under an exclusive arrangement. The objective is to gain a level of coverage and retain some semblance of control (influence) over how a product is sold, how an image is portrayed, and other factors that might affect the product's sales and reputation.

Most manufacturers that distribute through a multistage distribution system turn to a selective implementation of distribution. Selective distribution (along any number of different dimensions) is one way for the manufacturer to balance the breadth and depth of distribution effort to maximize long-run profit.[5] Depending on product and consumer characteristics, some manufacturers employ more selective distribution strategies while others employ less selective approaches. The product and consumer characteristics that argue for exclusive distribution approaches usually support more selective strategies, while the product and consumer characteristics that argue for intensive distribution approaches usually support less selective strategies. In selective distribution, the manufacturer tries to employ the channels most likely to appeal to the most customers. One does not, for example, generally find copies of Microsoft software at a grocery store, nor breakfast cereal at an office-supply store.

Manufacturers in many industries have opted for selective distribution. A May 21, 2007 report on National Public Radio's *Morning Edition* about Chrysler's automobile dealer network provides an example of an already selective distribution channel becoming more so. The report states:

> Automakers are now trying to thin their dealer ranks. Chrysler, for example, has cut the number of dealers by about 10% in the last four years, to about 3,700, and says it will eliminate hundreds more…The automaker wants its dealers to have larger geographic territories, a broader customer base, and *less competition with others selling the same brand*…Profitable dealers spend more on advertising, they invest in new facilities, and they provide the kind of atmosphere people are looking for as they shop for new cars.[6]

Manufacturers understand that broader distribution of their products is not always in the best long-term interest of their firms.

Considerations

In spite of the potential pitfalls, many manufacturers prefer wide distribution among many competing resellers, especially those that focus sales efforts on their products. Wide distribution increases the likelihood that a consumer will encounter its products and also encourages more reseller competition, leading to lower reseller margins, lower prices to consumers, and (theoretically, at least) higher manufacturer sales. Manufacturers want resellers that focus an appropriate level of selling effort on their products. If reseller margins are too low, the reseller's incentive to promote a particular manufacturer's product is reduced. One way to obtain higher reseller promotion effort is to have resellers that do not offer directly competitive products. For the manufacturer, it is better that the products are available in the channel in which the end user shops as opposed to being widely available. This is particularly true with new technology or products in the nascent stages of their life cycles.

[5] "Selective distribution strategies trade off broad coverage, convenient availability, and low retail margins on the one hand, against higher margins and prices with more retailer push on the other. As Red Bull and Snapple have shown, it may not be easy to classify productions into historical 'convenience' and 'shopping' goods categories to make this judgment." Paul W. Farris, "Using Steiner's Dual-Stage Model to Develop Better Measures of Retail Distribution," *The Antitrust Bulletin* (Winter 2004): 952.

[6] Wendy Kaufman, "Chrysler Sale May Accelerate Dealership Closings," National Public Radio's *Morning Edition*, May 21, 2007, http://www.npr.org/templates/story/story.php?storyId=10285604 (accessed May 2007), emphasis added.

Fundamentally, manufacturers and resellers seek distribution systems with diametrically opposed characteristics, at least along some dimensions. Resellers prefer less reseller competition while manufacturers prefer more; resellers prefer a larger portfolio of competing products while manufacturers would prefer exclusivity. Although the system that emerges reflects the interplay of negotiations and decisions between manufacturer and reseller—and their respective strength and ability in negotiations—both are ultimately constrained by the needs of the consumer.

Designing a Channel of Distribution[7]

Channel design consists of a series of steps and can be compared to fundamental principles in marketing—segmentation, positioning, and targeting, then establishing (or refining) the channel. Because distribution channels are built backward from the customer, the best starting point is to begin with the question: How does the customer want to be met in the marketplace? One then focuses on the various *segments* served by the manufacturer, since different segments should demand different outputs from the marketing channel. One segment might need a great deal of handholding and require that the channel provide a wide array of value-added services and functions. Another segment, meanwhile, might require only a few services and want just to buy the product as cheaply as it can. Conceptually, these two channels could peacefully co-exist if we could isolate the channel so that one segment shopped only in its channel and the other segment shopped only in its channel. It is very difficult to isolate, or *bound*, the channel since consumers tend to frequent multiple channels; the two channels might conflict, especially in relation to the free-rider problem. Let us assume, however, that it is possible to *minimize* the overlap among segments and channels. The objective of the *segmentation* step is to understand the needs of the different segments and how a channel can be configured to align with these requirements.

In the second step, *positioning*, the channel that optimally serves each of the key segments is identified. The manager might discover that some segments cannot be served because of the resources required to meet their needs. This is very much a matching process that comprises the following:

- Channel flows: These are the activities that add value to the end user and might include a wide array of services beyond the traditional material-flow considerations.
- Channel structure: Structure encompasses the elements of the members of the channel and the intensity of distribution. The purpose is to identify the exact channel partners so that the manufacturer can be assured that its goals and objectives fit with the chosen segments. Again, the objective is to balance a sufficient level of segment responsiveness with the costs of providing this channel.

Targeting—deciding which segments will be served and which will not be—is influenced by a number of internal and external factors ranging from "managerial bandwidth" to resource allocations and competitive realities. Beginning with a blank sheet of paper and building a channel from scratch might be difficult due to costs and the need to remove nonvalue-adding activities, so the manager must reach a compromise between the ideal and the affordable. As an extension of targeting, the manager will establish the actual channel; where none exists, one must be developed, and where a viable channel does exist, it must be refined.

Next is *implementation*, where the manager must address issues of power, conflict, and channel coordination. Problems arise when supplier and channel are not aligned on key issues or when channel members compete for the same incentives. The objective is to enhance coordination and avoid dysfunctional conflict. *Channel power* is the ability of one channel member to control the decisions of another member in the

[7] This section is modified from Coughlan et al.

distribution system. *Channel conflict* occurs when one channel member's actions prevent another from achieving its goals. Power can be used to reduce conflict.

Three types of channel conflict may affect distribution design and implementation: *vertical*, or conflict between supplier and reseller within a given channel; *horizontal*, or conflict among members of a given channel; and *multichannel*, or conflict among supplier, members, and resellers comprising a different channel.[8] Channel conflict arises over issues of coverage, control, and efficiency. Every industry has channel conflict to some degree, because the interests of independent business entities do not always coincide. The level of effort expended and expected by each party, the exercise of power on the part of one party or the other, and the ever-present temptation to "free-ride" on the efforts of others all enter into consideration.

Much vertical channel conflict arises because of the inherently opposed incentives discussed above: manufacturers generally want the most intensive or vigorous distribution they can get, while resellers prefer less intensive distribution because competition at the reseller level leads to lower resale margins, so they often redirect their selling efforts away from a product with higher competition and lower margins toward products with lower competition and higher margins. Channel conflict between manufacturers and resellers over the level of competition at resale is ever-present.

Changing Channel Designs[9]

Three factors can force management to change its channel design. The first is a proliferation of customer needs. When markets are stable and uncertainty is low, there is little need to consider a new channel design, but the more the end user demands a unique solution, the more likely market fragmentation becomes, which in the extreme can lead to segments of one. Mass customization is but one approach where a channel must be designed to accommodate individual needs and rising customer expectations.

The second factor is a shift in power from one level in the channel to another. Often, *disintermediation*—where one channel member takes on another's activities or renders them obsolete or unnecessary—raises concern, as will the threat of *backwards integration*. Increased concentration in certain channel structures can shift power from the manufacturer to the buyer: a decrease in customers can exert pressure to reduce price, enhancing the buyer's bargaining power, or more knowledgeable buyers can decrease the asymmetry in information.

The third factor is a change in strategic priorities. Not only do firms outsource noncore activities, they also configure channels with experts who meet customers' needs more cheaply through effective execution of vital channel tasks. We have witnessed a growth in channel partnerships where firms combine activities in *virtual* rather than vertical integration.

Corey et al., devote a chapter in their study *Going to Market* to "Coping with Change."[10] Early in this chapter, they identify a number of "imperatives of change." The factors that create market ferment and lead sooner or later to the reconfiguration of distribution systems include the following:

- Growth and maturation of existing product markets
- Emergence of new product markets
- Significant market decline

[8] Kotler and Keller, 491.
[9] This section is adapted from Anderson et. al., "Strategic Channel Design," 59–69.
[10] E. Raymond Corey, Frank V. Cespedes, and V. Kasturi Rangan, *Going to Market* (Harvard Business School Press, 1989), 187–203.

- Escalation of competition and intensification of cost/price pressures
- Changes in customer demographics and modes of buyer decision making
- Changes in the channels infrastructure (some reseller institutions grow in market power and others decline)
- Corporate mergers and resulting opportunities for integrating the channel systems of two or more businesses
- One-shot opportunities to increase market share by taking over competitors' distributors.[11]

Changes in technology, society, and competitors' focus will inevitably require change in existing distribution systems.12 Even if a specific distribution system is well-designed at its inception, changes inevitably accumulate, as do pressures to accommodate those changes. Wroe Alderson observed:

> Because of these competitive attempts from either side to organize the market, the marketing channels are in a continual state of flux. New types of marketing firms and marketing arrangements appear, and old ones pass out of existence…[The] over-all trend is…toward more effective markets and marketing channels through the endless quest for differential structural advantages.[13]

To emphasize the point that these channel changes are generally improvements, Alderson quoted the eminent economist Alfred Marshall to point out that "economic progress consists largely in finding better methods for marketing at a distance."[14] True to these observations, changes in technology and pressures of competition have changed the methods by which many products are distributed from the manufacturer to the ultimate consumer.[15] Wholesalers (and the manufacturers that rely on them) who see their role primarily as logistics operators should worry the most about their future.

Recent Trends in Channels of Distribution

The National Association of Wholesaler-Distributors publishes a trends study in which it surveys its members in order to understand what factors seem to lead to change. In its book Outlook 2006, the following trends were mentioned:[16]

1. *Customer self-service*: More and more customers will rely on technology to perform tasks that previously had been done by their distributors. This will place pressure on distribution to find new ways to create value for customers. To be sure, the Internet has already proven to be an invaluable tool to check order status, learn about new products, and the like.
2. *Strategic sourcing*: Again, in an effort to reduce costs, multilocation purchasing executives will work harder to limit the discretionary purchasing behavior of local buyers so that they can better leverage the strength of the corporate buy. Distributors will find that they will need to sign more contracts

[11] Corey et al., 188.

[12] For an account of the changing nature of control structures in distribution channels see Barton A. Weitz and Sandy D. Jap, "Relationship Marketing and Distribution Channels," *Journal of the Academy of Marketing Science* 23:4 (1995): 305–20.

[13] Wroe Alderson, *Marketing Behavior and Executive Action* (Homewood, IL: Richard D. Irwin, 1957), 214, 335–36.

[14] Alderson.

[15] Corey et al., provide a brief history of the evolution of the distribution infrastructure in the United States, focusing on industrial products. E. Raymond Corey, Frank V. Cespedes, and V. Kasturi Rangan, Chapter 12 in *Going to Market* (Harvard Business School Press, 1989).

[16] National Association of Wholesaler-Distributors, Distribution Research and Education Foundation and Pembroke Consulting, *Facing the Forces of Change: The Road to Opportunity* (Washington, D.C.: Distribution Education and Research Foundation, 2006).

with larger customers to ensure the lower prices expected through the consolidated purchasing initiatives.

3. *Fee-based services*: To better serve customers with new value-added services, distributors will have to develop a fee-based model. Although some customers will be slow to accept these fees and will walk from established relationships, this business model has merit.

4. *Logistics and fulfillment*: Logistics companies are on a collision course with distributors for control of the supply chain. Suppliers are already treating logistics companies as viable alternatives for certain specific activities in wholesale distribution, with more than half of the *Fortune* 500 companies currently outsourcing some supply chain functions to logistics companies. As a way to capture more of the value chain, a number of logistics firms are integrating backwards to provide wholesale distribution functionality. In fact, many suppliers view their logistics carriers as viable alternatives to wholesale distribution. As customers look to logistics firms to provide these services, wholesale distribution stands to lose its longstanding share of channel sales.

5. *Technology spending*: This will grow in importance; in order to better align with their customers, wholesale distributors will increase their IT spending to gain insight into customer-performance metrics, to develop new ways to meet customer requirements, and to more professionally manage their operations.

Channel Incentives: The Use of Margins

The conflicts, trade-offs, and tensions that manufacturers and wholesalers face—internally and with each other—require coordination, which to some degree could be achieved by command or legally enforceable contract, although such methods seldom inspire willing and enthusiastic participation; usually, the prudent solution is for one party to provide another with incentives.[17] In theory, a manufacturer wants a lot of effort at a low cost from the wholesaler, while the wholesaler, who wants high remuneration for any effort, will have a range of incentives from other manufacturers with which to leverage its position.

To understand how incentives align interests, a good place to start is with *distributor margins*, the difference between the price received from the buyer (most often a retailer selling to an end consumer) and the price paid to the manufacturer (or an upstream wholesaler). The distributor margin can be expressed either as a percentage of the relevant prices at each stage in the process or as dollars per unit sold.

Determining net selling and buying prices can be surprisingly difficult because of the various allowances earned from suppliers and granted to customers. In most industries, wholesalers set their own margins as they determine their selling prices and can negotiate and choose whether to buy goods at the given purchase prices.

Although manufacturing marketing personnel often say they "give the channel a margin," this is neither the way it actually works, nor how distributors/wholesalers and retailers perceive the situation. Manufacturers frequently offer distributors additional compensation in return for early payment of invoices (terms), meeting sales goals (volume rebates or incentives), buying in minimum-sized lots (e.g., truckload discounts), or performing services (merchandising or promotional allowances).

[17] A recent paper in a leading economics journal presented a useful, if limited, theoretical perspective on the design of incentive programs that is germane to this discussion: "The purpose of this paper is to argue that, from the point of view of *optimal incentives*, *differential rewards may be unavoidable* even when individuals are *completely identical* and when the mechanism aims at inducing all agents to *exert effort*." This article demonstrates, using only mathematics and logic, that principals (such as manufacturers) may have to compensate agents (such as wholesalers) with different levels of incentive payments to elicit optimal effort on behalf of the principle even if all agents are identical. Eyal Winter, "Incentives and Discrimination," *American Economic Review* 94:3 (June 2004): 764, italics added.

Another way to compensate resellers is to engage in *functional discounting*, in which the margin is based not on one's position in the channel but on performance. Typically, a distributor will receive one margin percentage and a retailer another, but under functional discounting a reseller receives payment only after certain activities on behalf of the manufacturer are performed. Keep in mind that every action by the distributor or by the manufacturer must somehow benefit the customer.

In addition, we ought to consider some distributor-level activities as candidates for functional discounts: to compensate the channel, for instance, for participating in flows previously performed by the manufacturer, where the discount bears a relationship to the cost savings achieved by the supplier—paying the channel for performance, in other words, and not for the position it plays in the value stream. Activities with inherent value should be treated as such, so effort is rightfully expended in determining how the margin structure is allocated and what may be achieved through functional rather than position-based discounting.

Without a well-designed system of incentives, manufacturers may find that distributor interests do not coincide sufficiently with their own and that tensions over preferences become exacerbated.[18] A distributor may wish to take on a competitive line or devote more sales effort to a different product to the detriment of the established manufacturer. Alternatively, the distributor may wish to raise prices, earning higher unit margins at the cost of selling lower volumes.

Corporate Brands and the Role of Channel Partners

As a final consideration, the strength and nature of a manufacturer's corporate reputation and brand image also affect the design and implementation of a distribution strategy. The complex interaction of brand image and distribution policy can result in a number of different strategies;[19] manufacturers of well-recognized brands, for example, may vary distribution strategies based on brand images or other characteristics. As used here, the term *corporate reputation* extends beyond the notion of brand image in the eyes of consumers to encompass all the relationships—contractual and noncontractual—that emerge as producers and resellers conduct business with each other.[20]

In some cases, having a respected brand allows a manufacturer to engage in a highly intensive distribution strategy, resulting in a product available in almost every conceivable venue. Coca-Cola and Pepsi are good examples, as their products are highly advertised and almost universally available. This distribution ubiquity increases the level of price competition faced by the reseller, but Coca-Cola continues to monitor its brand, sending shoppers into restaurants to order Coke products; if the establishment is not a Coke retailer and fails to inform the shopper that it does not serve Coke products, it is put on notice that such behavior must stop. When competition squeezes margins so much that resellers are unable to focus sufficiently on the product, manufacturers may have to compensate them directly to protect the integrity of the brand.

In other instances, the reseller provides value-added services that become part of the total product offering. Hewlett Packard (HP) directs much of its sales through third-party channels to provide the custom solutions and intimate customer knowledge it cannot. If the reseller does not delight the customer, HP suffers

[18] For some insights on the matter of channel-member goal congruence, see Erin Anderson, Leonard M. Lodish, and Barton A. Weitz, "Resource Allocation Behavior in Conventional Channels," *Journal of Marketing Research* XXIV (February 1987): 85–97.

[19] The study of brand names, image, and equity is a major focus in marketing theory and practice, and the literature is voluminous. A good overview treatment of brands is in Chapters 9 through 11 of Kotler and Keller.

[20] For an account of the changing nature of control structures in distribution channels, see Barton A. Weitz and Sandy D. Jap, "Relationship Marketing and Distribution Channels," *Journal of the Academy of Marketing Science* 23, no. 4 (1995): 305–20. For an academic treatment of investments in the buyer-seller relationship, see Sandy D. Jap, "Perspectives on Joint Competitive Advantages in Buyer-Supplier Relationships," *International Journal of Research in Marketing*, 18, no. 1–2 (June 2001): 19–35. For some insights on the matter of channel-member goal congruence, see Anderson, et. al., "Resource Allocation Behavior in Conventional Channels."

because that reseller is its authorized agent. Thus it is easy to see that channel-partner selection is a strategic decision not to be taken lightly. In this instance, competitive advantage is a function of HP and its entire set of channel partners, as it is of Cisco and its entire set of channel partners; HP and Cisco are each as strong as their weakest partner.

As important as a brand image is in the eyes of consumers, a corporate reputation for expertise and trustworthiness in the eyes of distribution channel members is crucial. A manufacturer that cannot deliver reliable and desirable products to the channel in an appropriate time frame will receive a negative review from its members; an opportunistic manufacturer that pulls products, expands distribution, or changes credit or delivery terms will also suffer from negative criticism. In short, a manufacturer that cannot control and deliver on its strategy will lose reseller support.[21]

Known primarily by the company it keeps, a reseller must often rely on manufacturers to bolster its brand equity, since relying on a partner of questionable reputation can immediately tarnish one's own. An obvious problem exists when a firm relies on low-cost country sourcing to improve its competitive-cost position: if the quality of the purchased component is not up to specifications, the buyer's product could be rendered undesirable in the marketplace, with disastrous consequences. Several years ago, Chrysler recalled Jeeps because the fuel gauge was registering full when the tank was empty. A root-cause analysis showed that a third-tier supplier, attempting to reduce costs, used paint that changed the electro-mechanical properties of the gauge. Instead of saving a few cents, Chrysler spent millions on the recall and still had to contend with the negative press that resulted.

Final Thoughts

Channel decisions are among the more complicated that marketing executives must make, often affecting all the elements in the marketing mix, influencing decisions to serve particular groups of customers, and altering the competitive landscape; moreover, because of the strategic implications, these decisions are among the more time-consuming to implement. In the extreme, changing a channel can be tantamount to betting the business, since failure can mean the loss of key customers and the severe erosion of margin and price.

Aligning distribution channels with customer needs requires an in-depth appreciation of the behaviors and attitudes of key segments, the actions of competitors, and the unique skills and capabilities that channel partners bring to the value equation. Recall that if we parse out the entire set of attributes and features a firm brings to the marketplace, a number of these elements are the responsibility of the channel. A channel partner's failure to execute its role or represent the manufacturer faithfully in the marketplace not only can result in losses but also can damage both the manufacturer's relationship with customers and its reputation.

Designing a channel of distribution that fulfills a firm's strategic vision is not to be taken lightly, nor does it come easily: independent actors must come to share a common purpose and develop a collaborative approach. But those that do sustain challenges that would threaten weaker relationships experience little conflict and are ultimately more profitable.

[21] Kotler and Keller, 228–30.