Distribution Channels and Institutions

Meaning of Distribution Channel

Distribution channel is a chain of businesses or intermediaries through which a good or service passes until it reaches the final buyer or the end consumer. Distribution channels can include wholesalers, retailers, distributors, and even the Internet.

Distribution channels are part of the downstream process, answering the question "How do we get our product to the consumer?" This is in contrast to the upstream process, also known as the supply chain, which answers the question "Who are our suppliers?"

A distribution channel is a path by which all goods and services must travel to arrive at the intended consumer. Conversely, it also describes the pathway payments make from the end consumer to the original vendor. Distribution channels can be short or long, and depend on the number of intermediaries required to deliver a product or service.

Goods and services sometimes make their way to consumers through multiple channels—a combination of short and long. Increasing the number of ways a consumer is able to find a good can increase sales. But it can also create a complex system that sometimes makes distribution management difficult. Longer distribution channels can also mean less profit each intermediary charges a manufacturer for its service.

Distribution Intermediaries

It is common for a business to use one or more kinds of intermediary when it comes to getting a product or service to the end customer. Here are the main kinds of distribution intermediaries.

❖ **Retailers**

The most popular distribution channel for consumer goods, retailers operate **outlets that trade directly with household customers**. Retailers can be classified in several ways:

- Type of goods being sold (e.g. clothes, grocery, furniture)

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- Type of service (e.g. self-service, counter-service)
- Size (e.g. corner shop; superstore)
- Ownership (e.g. privately-owned independent; public-quoted retail group)
- Location (e.g. rural, city-centre, out-of-town)
- Brand (e.g. nationwide retail brands; local one-shop name)

Retailers enable producers to reach a wider audience, particularly if broad coverage by the major retail chains can be obtained. The big downside to using a retailer is the loss of profit margin. A high street retailer will typically look to take at least 40-50% of the final consumer price.

❖ **Wholesalers**

Wholesalers stock a range of products from several producers. The role of the wholesaler is to sell onto retailers. Wholesalers usually specialize in particular products – for example food products.

❖ **Distributors and dealers**

Distributors or dealers have a similar role to wholesalers – that of taking products from producers and selling them on. However, they often sell onto the end customer rather than a retailer. They also usually have a much narrower product range. Distributors and dealers are often involved in providing after-sales service.

❖ **Franchises**

Franchises are independent businesses that operate a branded product (usually a service) in exchange for a license fee and a share of sales. Franchises are commonly used by businesses (franchisors) that wish to expand a service-based product into a much wider geographical area.

❖ **Agents**

Agents sell the products and services of producers in return for a commission (a percentage of the sales revenues). You will often find agents working in the service sector. Good examples

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include travel agents, insurance agents and the organizers of party-based selling events (e.g. Tupperware and Pampered Chef).

Functions of Intermediaries

Intermediaries in a distribution channel provide services that enable manufacturers to reach different types of customers. A channel might include a number of intermediaries, such as agents, wholesalers, distributors and retailers. Intermediaries act as middlemen between different members of the distribution chain, buying from one party and selling to another. They also may hold stock and carry out logistical and marketing functions on behalf of manufacturers. Following are some functions of intermediaries-

1. Reaching More Customers through Retailers

Independent stores and retail chains sell products to consumers and business customers. By appointing retailers, manufacturers can reach different areas of the country and target smaller customers they could not afford to serve directly. Retailers buy products for resale direct from manufacturers or from wholesalers. They generally stock goods from many different suppliers, including competitive offerings in the same product category, so manufacturers must use incentives and discounts to encourage retailers to push their products in order to achieve strong sales.

2. Cooperative Marketing through Distributors

Distributors carry out similar functions to wholesalers, but generally have closer working relationships with manufacturers. Distributors may have exclusive arrangements with manufacturers and do not carry competing products. They may be part of a franchise, only offering the products of one manufacturer. Like wholesalers, they provide valuable warehousing and logistical functions for manufacturers. They may also participate in cooperative marketing programs with suppliers, improving sales for manufacturers.

3. Warehousing and Transportation

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Once the wholesaler has purchased a mass quantity of goods, it needs to get them to a place where they can be purchased by consumers. This is a complex and expensive process. McLane Company operates eighty distribution centers around the country. Its distribution center in Northfield, Missouri, is 560,000 square feet big and is outfitted with a state-of-the art inventory tracking system that allows it to manage the diverse products that move through the center. It relies on its own vast trucking fleet to handle the transportation.

4. Purchasing

Wholesalers purchase very large quantities of goods directly from producers or from other wholesalers. By purchasing large quantities or volumes, wholesalers are able to secure significantly lower prices.

Imagine a situation in which a farmer grows a very large crop of potatoes. If he sells all of the potatoes to a single wholesaler, he will negotiate one price and make one sale. Because this is an efficient process that allows him to focus on farming (rather than searching for additional buyers), he will likely be willing to negotiate a lower price. Even more important, because the wholesaler has such strong buying power, the wholesaler is able to force a lower price on every farmer who is selling potatoes.

The same is true for almost all mass-produced goods. When a producer creates a large quantity of goods, it is most efficient to sell all of them to one wholesaler, rather than negotiating prices and making sales with many retailers or an even larger number of consumers. Also, the bigger the wholesaler is, the more likely it will have significant power to set attractive prices.

5. Simplifying Logistics through Wholesalers

Wholesalers buy products in bulk from a number of different manufacturers, stocking them in warehouses and selling them to retailers. By holding stock, wholesalers enable manufacturers to supply customers in different regions without investing in their own warehousing facilities. Wholesalers also help manufacturers reduce their logistics costs by delivering stock to retailers or offering stores a collection service.

6. Selling Through Agents

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Agents act as independent representatives for manufacturers, selling to other intermediaries such as wholesalers or retailers. These agents can be individuals or companies. Agents earn commission or fees for the sales they make or the services they provide. They form a valuable extension to a manufacturer's internal sales resources.

7. Direct and Indirect Channels

Manufacturers sell products and services to their customers through direct and indirect channels. Where manufacturers sell direct to customers through their own salesforce or website, they do not require intermediaries. If they wish to sell to customers and prospects their sales teams cannot reach, they appoint intermediaries to act on their behalf. Intermediaries may have additional resources and relationships to supplement to a manufacturer's own sales and marketing resources, enabling it to reach a wider customer base.

8. Grading and Packaging

Wholesalers buy a very large quantity of goods and then break that quantity down into smaller lots. The process of breaking large quantities into smaller lots that will be resold is called bulk breaking. Often this includes physically sorting, grading, and assembling the goods. Returning to our potato example, the wholesaler would determine which potatoes are of a size and quality to sell individually and which are to be packaged for sale in five-pound bags

9. Risk Bearing

Wholesalers either take title to the goods they purchase, or they *own* the goods they purchase. There are two primary consequences of this, both of which are both very important to the distribution channel. First, it means that the wholesaler finances the purchase of the goods and carries the cost of the goods in inventory until they are sold. Because this is a tremendous expense, it drives wholesalers to be accurate and efficient in their purchasing, warehousing, and transportation processes.

Second, wholesalers also bear the risk for the products until they are delivered. If goods are damaged in transport and cannot be sold, then the wholesaler is left with the goods and the cost.

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If there is a significant change in the value of the products between the time of the purchase from the producer and the sale to the retailer, the wholesaler will absorb that profit or loss.

10. Marketing

Often, the wholesaler will fill a role in the promotion of the products that it distributes. This might include creating displays for the wholesaler's products and providing the display to retailers to increase sales. The wholesaler may advertise its products that are carried by many retailers.

Wholesalers also influence which products the retailer offers. For example, McLane Company was a winner of the 2016 Convenience Store News Category Captains, in recognition for its innovations in providing the right products to its customers. McLane created unique packaging and products featuring movie themes, college football themes, and other special occasion branding that were designed to appeal to impulse buyers. They also shifted the transportation and delivery strategy to get the right products in front of consumers at the time they were most likely to buy. Its convenience store customers are seeing sales growth, as is the wholesaler.

11. Distribution

As distribution channels have evolved, some retailers, such as Walmart and Target, have grown so large that they have taken over aspects of the wholesale function. Still, it is unlikely that wholesalers will ever go away. Most retailers rely on wholesalers to fulfill the functions that we have discussed, and they simply do not have the capability or expertise to manage the full distribution process. Plus, many of the functions that wholesalers fill are performed most efficiently at scale. Wholesalers are able to focus on creating efficiencies for their retail channel partners that are very difficult to replicate on a small scale.

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