Marketing channels also keep changing in "person marketing." Besides live and programmed entertainment, entertainers, musicians, and other artists can reach prospective and existing fans online in many ways—their own Web sites, social community sites such as Facebook and Twitter, and 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 "educational-dissemination systems" and hospitals develop "health-delivery systems." These institutions must figure out agencies and locations for reaching a far-flung population.

Cleveland Clinic One of the largest and most respected hospitals in the country, Cleveland Clinic, provides medical care in a variety of ways and settings. The main campus in Cleveland, whose 50 buildings occupy 166 acres, is the hub for patient care, research, and education. Cleveland Clinic also operates 15 family primary-care centers in the suburbs. Eight hospitals extend the clinic's reach in Northeast Ohio. Community outreach programs in all these areas provide education and free health screenings. Cleveland Clinic also offers major medical care in Florida, Toronto, and, as of 2012, Abu Dhabi. It has a suite of secure online health services for both patients and physicians and is developing partnerships with Google and Microsoft to further its Internet capabilities.[16]

Cleveland Clinic provides health care services in a variety of different locations and settings.

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

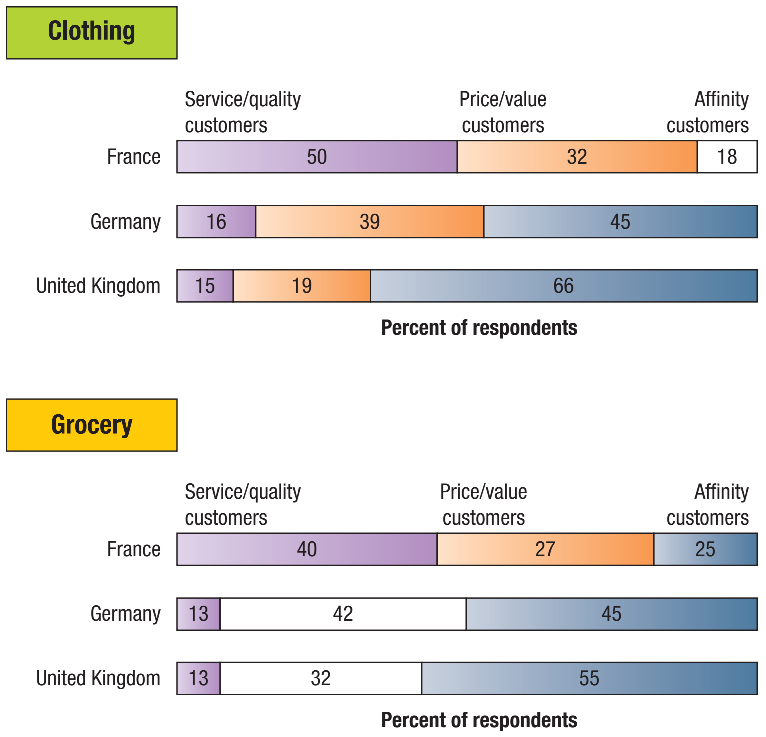
Consumers may choose the channels they prefer based on price, product assortment, and convenience, as well as their own shopping goals (economic, social, or experiential).[17] As with products, segmentation exists, and marketers must be aware that different consumers have different needs during the purchase process.

One study of 40 grocery and clothing retailers in France, Germany, and the United Kingdom found that they served three types of shoppers: (1) *service/quality customers* who cared most about the variety and performance of products and service, (2) *price/value customers* who were most concerned about spending wisely, and (3) *affinity customers* who primarily sought stores that suited people like themselves or groups they aspired to join. As Figure 15.3 shows, customer profiles differed across the three markets: In France, shoppers stressed service and quality, in the United Kingdom, affinity, and in Germany, price and value.[18]

Even the same consumer, though, may choose different channels for different functions in a purchase, browsing a catalog before visiting a store or test driving a car at a dealer before ordering online. 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.[19]

Channels produce five service outputs:

1. ***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.
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



|Fig. 15.3|

What Do European Consumers Value

Source: Peter N. Child, Suzanne Heywood, and Michael Kliger, "Do Retail Brands Travel?" *The McKinsley Quarterly*, 2002, Number 1, pp. 11–13. All rights reserved. Reprinted by permission of McKinsey & Company.

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, although too many choices can sometimes create a negative effect.[20]
5. ***Service backup***—Add-on services (credit, delivery, installation, repairs) provided by the channel. The greater the service backup, the greater the work provided by the channel.[21]

Providing greater 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 smaller service outputs if they can save money.

Establishing Objectives and Constraints

Marketers should state their channel objectives in terms of service output levels and 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.[22] 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. France's Auchan considered the presence of its French rivals Leclerc and Casino in Poland as key to its decision to also enter that market.[23] Apple's channel objectives of creating a dynamic retail experience for consumers was not being met by existing channels, so it chose to open it own stores.[24]

Apple Stores When Apple stores were launched in 2001, many questioned their prospects and *BusinessWeek* published an article titled, "Sorry Steve, Here's Why Apple Stores Won't Work." Fast-forward five years, and Apple was celebrating the launch of its spectacular new Manhattan showcase store. With almost 275 locations by the end of 2009, net revenue from stores totaled \$6.6 billion and represented roughly 20 percent of total corporate revenue. Annual sales per square foot of an Apple store have been estimated at \$4,700—the Fifth Avenue location is reported to do a staggering \$35,000 of business per square foot–compared to Tiffany's \$2,666, Best Buy's \$930, and Saks's \$362. Any way you look at it, Apple stores have been an unqualified success. Designed to fuel excitement for the brand, they let people see and touch Apple products—and experience what Apple can do for them—making it more likely they'll become Apple 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 Apple specialists who provide technical support, often free of charge. Although the stores upset existing retailers, Apple has worked hard to smooth relationships, in part justifying the decision as a natural evolution of its existing online sales channel.

Apple stores offer a unique brand experience to Apple enthusiasts and prospects.

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 with 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.

As Netflix did, companies should search for innovative marketing channels. Columbia House has successfully merchandised music albums through the mail and Internet. Harry and David and Calyx & Corolla have creatively sold fruit and flowers, respectively, through direct delivery.

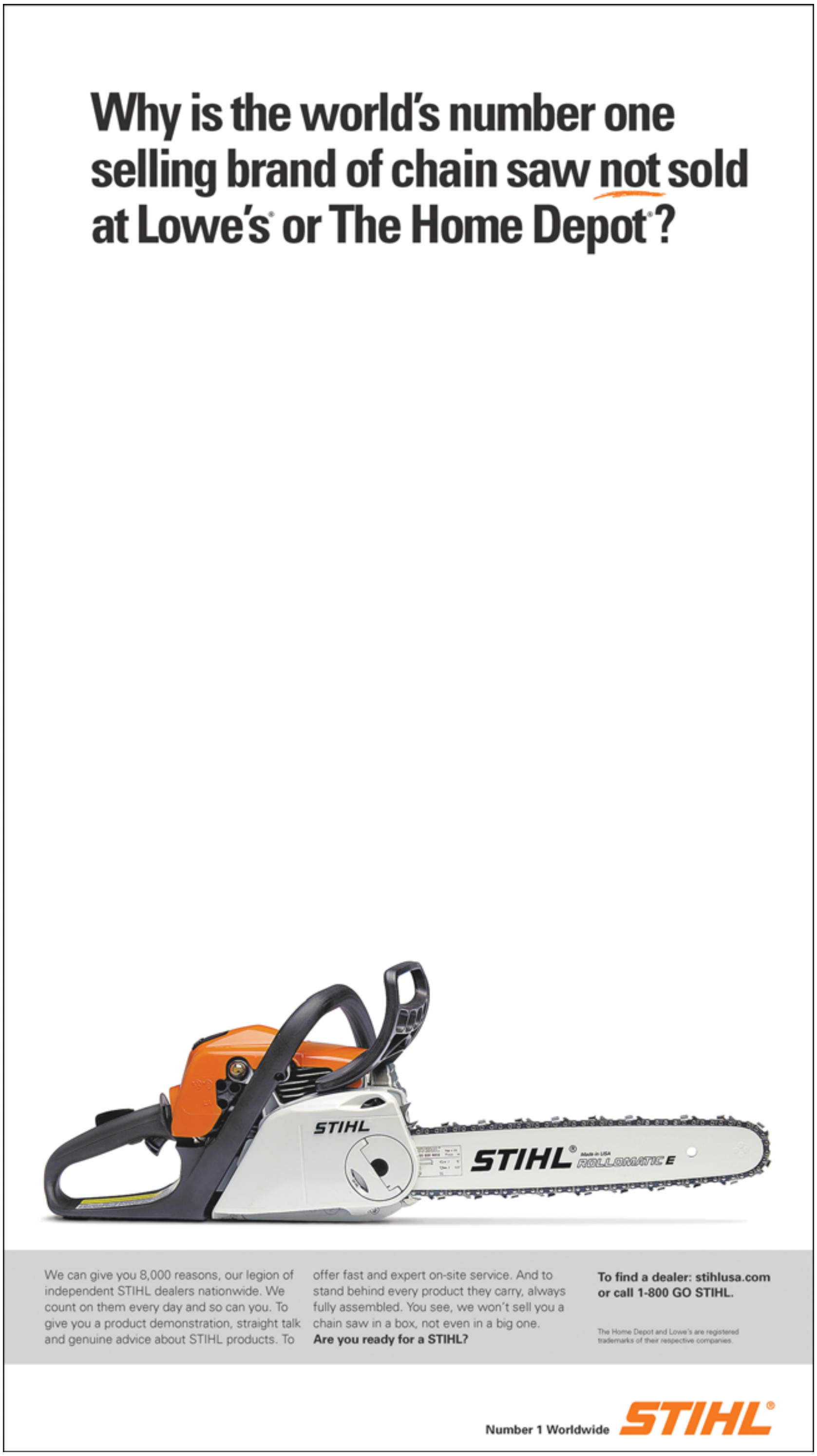
Sometimes a company chooses a new or unconventional channel because of the difficulty, cost, or ineffectiveness of working with the dominant channel. One advantage is often reduced competition, at least at first. Years ago, after trying to sell its inexpensive Timex watches through jewelry stores, the U.S. Time Company placed them instead in fast-growing mass-merchandise outlets. Frustrated with a printed catalog it saw as out-of-date and unprofessional, commercial lighting company Display Supply & Lighting developed an interactive online catalog that drove down costs, speeded the sales process, and increased revenue.[25]

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

Exclusive distribution means severely limiting the number of intermediaries. It's appropriate when the producer wants to maintain control over the service level and outputs offered by the resellers, and it often includes *exclusive dealing* arrangements. By granting exclusive distribution, the producer hopes to obtain more dedicated and knowledgeable selling. It requires a closer partnership between seller and reseller and is used in the distribution of new automobiles, some major appliances, and some women's apparel brands.

Exclusive deals are becoming a mainstay for specialists looking for an edge in markets increasingly driven by price.[26] 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.[27]

STIHL's selective distribution strategy includes 8,000 independent dealers but does *not* include other, broader forms of distribution.



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 selective distribution.

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 chain saws, it has expanded into string trimmers, blowers, hedge trimmers, and cut-off machines. It sells exclusively to six independent U.S. distributors and six STIHL-owned marketing and distribution centers, which sell to a nationwide network of more than 8,000 servicing retail dealers. The company is also a worldwide exporter of U.S. manufactured STIHL products to 80 countries. STIHL is one of the few outdoor-power-equipment companies that do not sell through mass merchants, catalogs, or the Internet.[28]

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, Circle K, and gas-station-linked stores such as ExxonMobil's On the Run have survived by selling items that provide just that—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.[29]

TERMS AND RESPONSIBILITIES OF CHANNEL MEMBERS Each channel member must be treated respectfully and 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.

- ***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.

Evaluating Major Channel Alternatives

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

ECONOMIC CRITERIA Each channel alternative will produce a different level of sales and costs. △ Figure 15.4 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 the average transaction at a full-service branch costs the bank $4.07, a phone transaction costs $.54, and an ATM transaction costs $.27, but a typical Web-based transaction costs only $.01.[30]

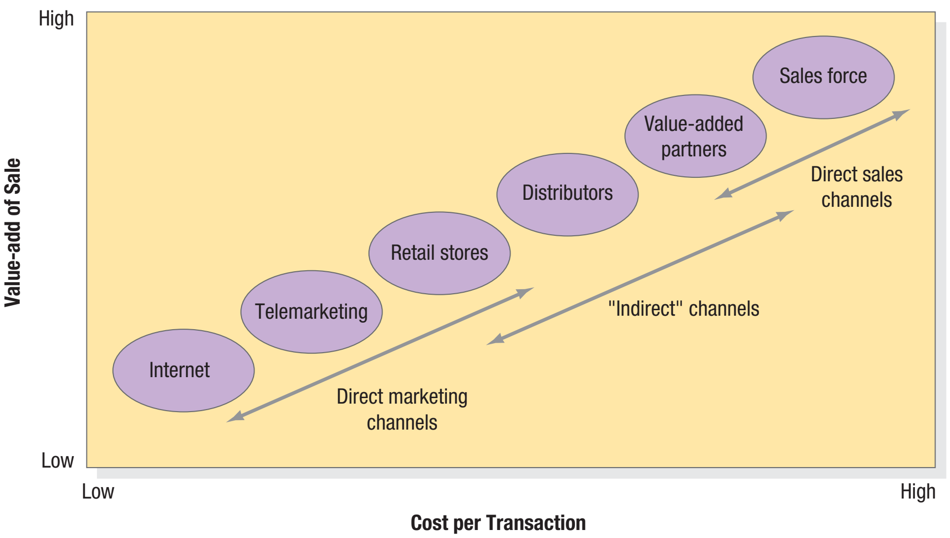
Firms will try to align customers and channels to maximize demand at the lowest overall cost. Clearly, sellers try to replace high-cost channels with low-cost channels as long as the value added per sale is sufficient. Consider the following situation:

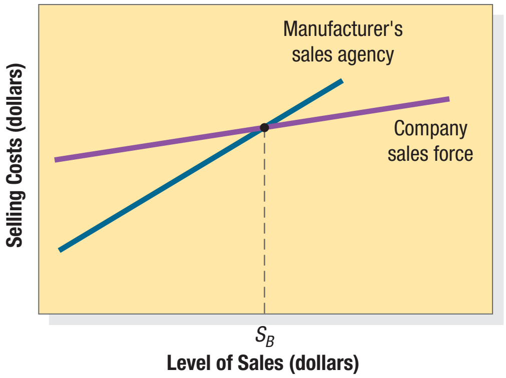
> A North Carolina furniture manufacturer wants to sell its line to retailers on the West Coast. One alternative is to hire 10 new sales representatives to operate out of a sales office in San Francisco and receive a base salary plus commissions. The other alternative is to use a San Francisco manufacturer's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

|Fig. 15.4| △

The Value-Adds versus Costs of Different Channels

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





|Fig. 15.5|

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

The first step is to estimate how many 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 because each rep's future depends on the company's success, and be more successful because many customers prefer to deal directly with the company. The sales agency however has 30 representatives, 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.

The next step is to estimate the costs of selling different volumes through each channel. The cost schedules are shown in Figure 15.5. Engaging a sales agency is less expensive than establishing a new company sales office, but costs rise faster through an agency because sales agents get larger commissions.

The final step is comparing sales and costs. As Figure 15.5 shows, there is one sales level (S_B) at which selling costs are the same for the two channels. 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 individual intermediaries for each channel. It must also modify channel design and arrangements over time. As the company grows, it can also consider channel 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 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.[31] 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.[32]

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. Manufacturers offer the nation's supermarkets between 150 and 250 new items each week, of which store buyers reject over 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 (in order of importance) 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.[33] 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.[34]

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 the inventories were actually 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.

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. The change could mean adding or dropping individual market channels or channel members or developing a totally new way to sell goods.

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, the firm 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 might grant exclusive franchises or sell through all willing outlets. In one country, it 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, company resources and capabilities, and other factors. Consider some of the challenges Dell has encountered in recent years.[35]

Dell

Dell Dell revolutionized the personal computer category by selling directly to customers via the telephone and later the Internet. Customers could custom-design the exact PC they wanted, and rigorous cost cutting allowed for low everyday prices. Sound like a winning formula? It was for almost two decades. But by 2006, the company was encountering problems that led to a steep stock price decline. First, reinvigorated competitors such as HP narrowed the gap in productivity and price. Always focused more on the business market, Dell struggled to sell effectively to the consumer market. A shift in consumer preferences to buying in retail stores didn't help, but self-inflicted damage from an ultra-efficient supply chain model that squeezed costs—and quality—out of customer service was perhaps the most painful. Managers evaluated call center employees primarily on how quickly they finished each call—a recipe for disaster as scores of customers felt their problems were ignored or not properly handled. A drop in R&D spending that hindered new-product development and led to a lack of differentiation didn't help either. Clearly, Dell had entered a new chapter in its history. A fundamental rethinking of its channel strategy and its marketing approach as a whole would consume the company for the next five years.

Channel Modification Decisions

A producer must periodically review and modify its channel design and arrangements.[36] 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.[37]

Adding or dropping individual channel members requires an incremental analysis. Increasingly detailed customer databases and sophisticated analysis tools can provide guidance into those decisions.[38] 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.[39] Avon's door-to-door system for selling cosmetics was modified as more women entered the workforce. Despite the convenience of automated teller machines, online banking, and telephone call centers, many bank customers still want "high touch" over "high tech," or at least they want the choice. Banks are thus opening more branches and developing cross-selling and up-selling practices to capitalize on the face-to-face contact that results.

Global Channel Considerations

International markets pose distinct challenges, including variations in customers' shopping habits, but opportunities at the same time.[40] In India, sales from "organized retail"—hypermarkets, supermarkets, and department stores—make up only 4 percent of the $322 billion market. Most shopping still takes place in millions of independent grocery shops or *kirana* stores, run by an owner and one or perhaps two other people.[41] Many top global retailers such as Germany's Aldi, the United Kingdom's Tesco, and Spain's Zara have tailored their image to local needs and wants when entering a new market.

Franchised companies such as Curves women's fitness centers and Subway sandwich shops have experienced double-digit growth overseas, especially in developing markets such as 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 a "mini-franchiser" in their own right. More knowledgeable about local laws, customs, and consumer needs than foreign companies, they sell and oversee franchises and collect royalties.[42]

Subway has franchise operators all over the world, including in the Doha City Center Shopping Mall in Qatar, shown here.

But many pitfalls exist in global expansion, and retailers must also be able to defend their home turf from the entry of foreign retailers. Selling everything from food to televisions, France's Carrefour, the world's second-biggest retailer, has encountered stiff competition in its home markets from smaller supermarkets for groceries and from specialist retailers such as IKEA or Fnac for other goods. Although strong in parts of Europe, Asia, and Latin America, Carrefour (which means "crossroads" in French) has been forced to cease operations in a number of countries, such as Japan, South Korea, Mexico, Czech Republic, Slovakia, Russia, Switzerland, and Portugal. Another of France's mega-retailers the Walmart-like Auchan, has been quite successful in entering emerging markets like China while unable to crack markets in the United States or Britain.[43]

The first step in global channel planning, as is often the case in marketing, is to get close to customers. To adapt its clothing lines to better suit 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 they increased costs, the blended American and European looks helped the retailer stand out.[44] Crossing the Atlantic the other way, Tesco introduced its Fresh & Easy gourmet minisupermarkets into California after 20 years of research that included spending time with U.S. families and videotaping the contents of their refrigerators. The retailer had gone through similar steps before entering China.[45]

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.

Topshop Founded by Sir Richard Green in the United Kingdom in 1994, clothing retailer Topshop is a chain of 310 UK stores and 116 international franchisees that commands intense loyalty from its trendy, style-obsessed customer base. Selling primarily party clothes, accessories, and daywear to women, Topshop blends English street fashion, reasonable prices, and fun services. A higher-end, quirkier version of fast-fashion chains H&M and Zara, Topshop allows middle-market consumers to dress upscale affordably. 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 up to 10 people), and Topshop Express (an express delivery service via Vespa scooters for fashion "emergencies"). The 60,000 square foot store on Broadway in New York City is Topshop's second biggest and first flagship store outside the United Kingdom.[46]

Topshop's unique combination of fashion, value, and fun is finding success both inside and outside the United Kingdom.

Channel Integration and Systems

Distribution channels don't stand still. We'll look at the recent growth of vertical, horizontal, and multichannel marketing systems; the next section examines 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*, owns or franchises the others or has so much power that they all cooperate. "Marketing Insight: Channel Stewards Take Charge" provides some perspective on how *channel stewards*, a closely related concept, can work.

Marketing Insight

Channel Stewards Take Charge

Harvard's V. Kasturi Rangan believes companies should adopt a new approach to going to market—**channel stewardship**. Rangan defines channel stewardship as the ability of a given participant in a distribution channel—a steward—to create a go-to-market strategy that simultaneously addresses customers' best interests and drives profits for all channel partners. The channel steward accomplishes channel coordination without issuing commands or directives by persuading channel partners to act in the best interest of all.

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 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 should appeal to any organization that wants to bring a disciplined approach to channel strategy. With the customer's point of view in mind, the steward advocates for change among all participants, transforming them into partners with a common purpose.

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

Rangan outlines three key disciplines of channel management:

1. *Mapping* at the industry level provides a comprehensive view of the key determinants of channel strategy and how they are evolving. It identifies current best practices and gaps, and it projects future requirements.
2. *Building and editing* assesses the producer's own channels to identify any deficits in meeting customers' needs and/or competitive best practices to put together a new and improved overall system.
3. *Aligning and influencing* closes the gaps and works out a compensation package in tune with effort and performance for channel members that add or could add value.

Channel stewardship works at the customer level, not at the level of channel institutions. Thus, channel managers can adapt their fulfillment of customer needs without having to change channel structure all at once. An evolutionary approach to channel change, stewardship requires constant monitoring, learning, and adaptation, but all in the best interests of customers, channel partners, and channel steward. A channel steward need not be a huge company or market leader; Rangan cites smaller players, such as Haworth and Atlas Copco, as well as distributors and retailers such as Walmart, Best Buy, and HEB (supermarkets).

Sources: V. Kasturi Rangan, *Transforming Your Go-to-Market Strategy: The Three Disciplines of Channel Management* (Boston: Harvard Business School Press, 2006); Kash Rangan, "Channel Stewardship: An Introductory Guide," www.channelstewardship.com; Partha Rose and Romit Dey, "Channel Stewardship: Driving Profitable Revenue Growth in High-Tech with Multi-Channel Management," *Infosys ViewPoint*, August 2007.

Vertical marketing systems (VMSs) arose from strong channel members' attempts to control channel behavior and eliminate conflict over independent members pursuing their own objectives. VMSs 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 obtain from a VMS,[47] and 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. Sears for years obtained over half the goods it sells from companies it partly or wholly owned. Sherwin-Williams makes paint but also owns and operates 3,300 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 Kodak, Gillette, and Campbell Soup command high levels of cooperation from their resellers in connection with 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.[48] 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. Profits pass back to members 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).[49]

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.

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 over 523 branches in supermarkets, making up roughly 35 percent 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.[50]

Integrating Multichannel Marketing Systems

Most companies today have adopted multichannel marketing. Disney sells its DVDs through five main channels: movie rental stores such as Blockbuster, 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 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.[51] Here are some of the channel options for leather goods maker Coach.

Coach Coach markets a high-end line of luxury handbags, briefcases, luggage, and accessories. Roughly 84 percent of its sales are via the Internet, catalog, company retail stores in North America, Japan, Hong Kong, Macau and mainland China, and its North American outlet stores. Coach also has store-in-store offerings in Japan and China inside major department stores. Ten percent of sales are from 930 U.S. department store locations, such as Macy's (including Bloomingdale's), Dillard's, Nordstrom, Saks (including Carson's) and Lord & Taylor, as well as some of those retailer's Web sites. Five percent of sales are from international wholesalers in 20 countries, mostly department stores. 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.[52]

Luxury goods maker Coach has a variety of carefully selected and managed channel options.

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, but those who buy in more than one channel are often more profitable than single-channel customers.[53] The second benefit is lower channel cost—selling by phone is cheaper than personal selling to small customers. The third is 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.

Clearly, companies need to think through their channel architecture and determine which channels should perform which functions. Figure 15.6 shows a simple grid to help make channel architecture decisions. The grid consists of major marketing channels (as rows) and the major channel tasks to be completed (as columns).[54]

The grid illustrates why using only one channel is 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. An integrated multichannel approach would be better. The company's marketing department could run a preselling campaign informing prospects about the company's products through advertising, direct mail, and telemarketing; generate leads through telemarketing, direct mail, advertising, and trade shows; and qualify leads into hot, warm, and 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, 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 20 stores and 5 outlets are limited by space to offering a selection only, and even its catalog promotes less than 70 percent of its total merchandise.[55] Other marketers prefer to limit their online offerings, theorizing that customers look to Web sites

Demand-generation Tasks

Marketing Channels and Methods — VENDOR → CUSTOMER

	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									
National account management									
Direct sales									
Telemarketing									
Direct mail									
Retail stores									
Distributors									
Dealers and value-added resellers									

|Fig. 15.6|

The Hybrid Grid

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

and catalogs for a "best of" array of merchandise and don't want to have to click through dozens of pages.

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 from achieving its goal. Software giant Oracle Corp., plagued by channel conflict between its sales force and its vendor partners, decided to roll out new "All Partner Territories" where all deals except for specific strategic accounts would go through select Oracle partners.[56]

Channel coordination occurs when channel members are brought together to advance the goals of the channel, as opposed to their own potentially incompatible goals.[57] 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

When Goodyear expanded its channels to include mass-market retailers, it angered its long-time independent dealers.

store Dayton Hudson reduced its space for Estée Lauder products.[58] Greater retailer consolidation—the 10 largest U.S. retailers account for over 80 percent of the average manufacturer's business—has led to increased price pressure and influence from retailers.[59] 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.[60]

- ***Multichannel conflict*** exists when the manufacturer has established two or more channels that sell to the same market.[61] 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 personal computers 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. 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.[62] The challenge is not to eliminate all conflict, which is

TABLE 15.2	Strategies to Manage Channel Conflict
Strategic justification	
Dual compensation	
Superordinate goals	
Employee exchange	
Joint memberships	
Co-optation	
Diplomacy, mediation, or arbitration	
Legal recourse	

impossible, but to manage it better. There are a number of mechanisms for effective conflict management (see Table 15.2).[63]

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 9—is a clear way to demonstrate that distinctiveness.

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 on the Web. Although lower than the agents' typical 10 percent commission for offline transactions, it did reduce tensions.[64]

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 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-option *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.

Legal Recourse If nothing else proves effective, a channel partner may choose to file a lawsuit. 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 a lawsuit. A settlement allowed for the mutual exploration of new service and distribution systems to supplement the DSD system.[65]

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 took a hit when they sold too many of their products in discount channels.

To reach affluent shoppers who work long hours and have little time to shop, high-end fashion brands such as Dior, Louis Vuitton, and Fendi have unveiled e-commerce sites as a way for customers to research items before walking into a store, and a means to help combat fakes sold on the Internet. Given the lengths to which these brands go to pamper customers in their stores—doormen, glasses of champagne, extravagant surroundings—they have had to work hard to provide a high-quality experience online.[66]

Legal and Ethical Issues in Channel Relations

Companies are generally free to develop whatever channel arrangements suit them. In fact, the law seeks to prevent them from using 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.

With *exclusive distribution*, only certain outlets are allowed to carry a seller's products. Requiring that these dealers not handle competitors' products is called *exclusive dealing*. Both parties benefit from exclusive arrangements: The seller obtains more loyal and dependable outlets, and the dealers obtain 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. One bitter lawsuit was brought by GT Bicycles of Santa Ana, California, against the giant PriceCostco chain, which sold 2,600 of its high-priced mountain bikes at a huge discount, upsetting GT's other U.S. dealers. GT alleges that it first sold the bikes to a dealer in Russia and that they were meant for sale only in Russia. The firm maintains that when discounters work with middlemen to get exclusive goods, it constitutes fraud.[67]

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 dealers is somewhat restricted. In general, sellers can drop dealers "for cause," but they cannot drop dealers if, for example, they refuse to cooperate in a doubtful legal arrangement, such as exclusive dealing or tying agreements.

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 in recent years, 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, online retailers can profitably sell low-volume products to niche markets. Online retailers 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.[68]

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; and Wine Spectator is a single-category specialist.

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—one estimate of the conversion rate of Internet shoppers in March 2008 was only about 35 percent. Worse, only 2 percent to 3 percent of visits to online retailers lead to sales, compared with 5 percent of visits to department stores.[69] 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.[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 are responding. Many now offer live online chat to give potential customers immediate advice about products and suggest purchasing additional items. When a representative is active in the sale, the average amount per order is typically higher. B2B marketers also need to put a human face on their e-commerce presence, and some are taking advantage of Web 2.0 technologies such as virtual environments, blogs, online videos, and click-to-chat.

To increase customer satisfaction and the entertainment and information value of Web-based shopping experiences, some firms are employing *avatars,* graphical representations of virtual, animated characters that act as company representatives, personal shopping assistants, Web site guides, or conversation partners. Avatars can enhance the effectiveness of a Web-based 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 processes can help reassure customers sensitive to online risk.[73] Online retailers are also trying new technologies such as blogs, social networks, and mobile marketing to attract new shoppers.

B2B E-COMMERCE Although business-to-consumer (B2C) Web sites have attracted much attention in the media, even more activity is being conducted on business-to-business (B2B) sites, which are changing the supplier–customer relationship in profound ways.

In the past, buyers exerted a lot of effort to gather information about worldwide suppliers. B2B 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 B2B auction sites, spot exchanges, online product catalogs, barter sites, and other online resources to obtain better prices. Ironically, the largest of the B2B market makers is Alibaba, homegrown in China where businesses have faced decades of Communist antipathy to private enterprise.

Alibaba The brainchild of Jack Ma, Alibaba began in 1999 and grew over the next decade to become the world's largest online B2B marketplace and Asia's most popular online auction site. Its numbers are staggering. The $9 billion company has 43 million registered users (35 million in China and 10.5 million internationally) and hosts more than 5.5 million shop fronts; at any moment, more than 4 million businesses are trading. At Alibaba's heart are two B2B Web sites: alibaba.com, a marketplace for companies around the globe to buy and sell in English, and china.alibaba, a domestic Chinese marketplace. The Chinese powerhouse has a nationalist agenda: to build markets for China's vast number of small and medium-sized businesses. Alibaba enables these businesses to trade with each other and link to global supply chains. 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 on Alibaba who has done business with a user is encouraged to comment on the firm, in the same way buyers comment on sellers in Amazon.com's or eBay's marketplace. Businesses are even starting to print "TrustPass" on their business cards, a true sign of Alibaba's B2B credibility. Global growth has become a priority. Home pages in Spanish, German, Italian, French, Portuguese, and Russian were launched in 2008 to complement Chinese and U.S. options. After its IPO of $1.7 billion in 2007 (second only to Google's among Internet firms), Alibaba, says Jack Ma, will "create the e-commerce platform for 10 million small enterprises creating 100 million jobs around the world and providing an online retail platform to supply the everyday needs of 1 billion people."[75]

Jack Ma has been the visionary force behind the highly successful Chinese online marketplace and auction site Alibaba.

The effect of these mechanisms is to make prices more transparent.[76] 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 may have initially debated whether to add an online e-commerce channel for fear of channel conflict with their offline retailers, agents, or their own stores, most eventually added the Internet as a distribution channel after seeing how much business was generated online.[77] 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, in part to be able to examine consumer shopping habits more closely.[78] Managing the online and offline channels has thus become a priority for many firms.[79]

Adding an e-commerce channel creates the possibility of a backlash from retailers, brokers, agents, and other intermediaries. The question is how to sell both through intermediaries and online. There are at least three strategies for trying to gain acceptance from intermediaries. One, offer different brands or products on the Internet. 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.

Harley-Davidson

Harley-Davidson Given that Harley sells more than $860 million worth of parts and accessories to its loyal followers, an online venture was an obvious next step to generate even more revenue. Harley needed to be careful, however, to avoid the wrath of 850 dealers who benefited from the high margins on those sales. Its solution was to send customers seeking to buy accessories online to the company's Web site. Before they can buy anything, they are prompted to select a participating Harley-Davidson dealer. When the customer places the order, it is transmitted to the selected dealer for fulfillment, ensuring that the dealer still 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. The Web site now gets more than 1 million visitors a month.[80]

Many brick-and-click retailers are trying to give their customers more control over their shopping experiences by bringing Web technologies into the store. Food Lion has experimented with personal scanners so customers can keep track of their supermarket purchases. Barnes & Noble has kiosks that allow customers to search inventory, locate merchandise, and order out-of-stock items.[81]

M-Commerce Marketing Practices

The widespread penetration of cell phones and smart phones—there are currently more mobile phones than personal computers in the world—allows people to connect to the Internet and place online orders on the move. Many see a big future in what is now called *m-commerce* (*m* for *mobile*).[82] The existence of mobile channels and media can keep consumers connected and interacting with a brand throughout their day-to-day lives. GPS-type features can help identify shopping or purchase opportunities for consumers for their favorite brands.

Although in 2009 only one in five phones in the United States was a smart phone such as an iPhone or BlackBerry, sales of smart phones are forecast to exceed those of regular phones by 2011. As their penetration and adoption of 3G increases, and as easy payment options and various apps for mobile phones are developed, m-commerce will take off. By 2015, more people are expected to access the Internet with mobile phones than with PCs.[83]

In some countries, m-commerce already has a strong foothold. Millions of Japanese teenagers carry DOCOMO phones available from NTT (Nippon Telephone and Telegraph). They can also use their phones to order goods. Each month, the subscriber receives a bill from NTT listing the monthly subscriber fee, the usage fee, and the cost of all the transactions. Bills can be paid at the nearest 7-Eleven store.

In the United States, mobile marketing is becoming more prevalent and taking all forms.[84] Retailers such as Amazon.com, CVS, and Sears have launched m-commerce sites that allow consumers to buy books, medicine, and even lawn mowers from their smart phones. The travel industry has used m-commerce to target businesspeople who need to book air or hotel reservations while on the move.[85]

One Nordstrom salesperson increased the amount of merchandise he sold by 37 percent by sending text messages and e-mails of news and promotions to the cell phones of his customers.[86] Mobile marketing can have influence inside the store too. Consumers increasingly are using a cell phone to text a friend or relative about a product while shopping.

Here is how Dunkin' Donuts developed an m-commerce strategy to complement its broader marketing efforts.

Dunkin' Donuts

Dunkin' Donuts Dunkin' Donuts targets busy people on the go, serving 2.7 million customers daily at approximately 8,800 stores in 31 countries, including roughly 6,400 U.S. locations. Portability remains an essential part of the value proposition, evidenced in the campaign theme, "America Runs on Dunkin.'" Knowing that many customers make a "Dunkin' Run" or visit, especially in the afternoon to bring back goodies for others, the company introduced new interactive Web tools and an iPhone application to create a social group ordering experience. The Dunkin' Run mobile campaign featured interactive alerts set to a customer's list of friends or coworkers, telling them when a trip to Dunkin' Donuts was planned, along with a personal message inviting them to place an order online. Invitees could view the menu to make an order or use a personalized list of favorites. All the orders were integrated onto a single screen that the runner could print out or display on a mobile and bring to the store. Dunkin' Run was not the company's first mobile marketing effort. An earlier two-month SMS promotional campaign in Italy increased sales almost 10 percent.[87]

Mobile marketing and the fact that a company can potentially pinpoint a customer or employee's location with GPS technology also raises privacy issues. What if an employer learns an employee is being treated for AIDS at a local clinic, or a wife finds her husband is out clubbing? Like so many new technologies, location-based services have potential for good or harm and ultimately will warrant public scrutiny and regulation.

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.
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. All marketing channels have the potential for conflict and competition resulting from such sources as goal incompatibility, poorly defined roles and rights, perceptual differences, and interdependent relationships. There are a number of different approaches companies can take to try to manage conflict.
8. Channel arrangements are up to the company, but there are certain legal and ethical issues to be considered with regard to practices such as exclusive dealing or territories, tying agreements, and dealers' rights.
9. E-commerce has grown in importance as companies have adopted "brick-and-click" channel systems. Channel integration must recognize the distinctive strengths of online and offline selling and maximize their joint contributions.
10. An area of increasing importance is m-commerce and marketing through smart phones and PDAs.

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 really affect the brand images of the products they sell that much *versus* Channel images must be consistent with the brand image.

Marketing Discussion

Channel Integrations

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, Amazon.com started as the "world's largest bookstore" in July 1995. A virtual bookstore that physically owned no books, Amazon.com promised to revolutionize retailing. Although some may debate whether it accomplished that, Bezos clearly blazed a trail of e-commerce innovations that many have studied and followed.

Amazon.com set out to create personalized storefronts for each customer by providing more useful information and more choices than could be found in your typical neighborhood bookstore. Readers can review books and evaluate them on a one- to five-star rating scale, and browsers can rate the reviews for helpfulness. Amazon.com's personal recommendation service aggregates data on buying patterns to infer who might like which book. The site offers peeks into books' contents, index, and beginning pages with a "search inside the book" feature that also lets customers search the entire text of 120,000 books—about as many titles as are in a Barnes & Noble bookstore. Amazon.com's one-click shopping lets buyers make purchases with one click.

Over the years, Amazon.com has diversified its product lines into DVDs, music CDs, computer software, video games, electronics, apparel, furniture, food, toys, and more. In addition, it has established separate Web sites in Canada, the United Kingdom, Germany, France, China, and Japan. Amazon.com continued to expand its product offerings with the 2007 launch of Amazon Video On Demand, allowing consumers to rent or purchase films and television shows on their computers or televisions. Later that year, Amazon.com introduced Amazon MP3, which competes directly with Apple's iTunes and has participation from all the major music labels. The company's most successful recent product launch was the Amazon-branded Kindle, an electronic book reader that can deliver hundreds of thousands of books, magazines, blogs, and newspapers wirelessly in a matter of seconds. As thin as a magazine and light as a paperback, the device was Amazon.com's number one selling product in 2009.

To overcome the lag between purchase and delivery of product, Amazon.com offers fast, inexpensive shipping. For a $79 annual fee, Amazon.com Prime provides unlimited free express shipping for most items. While free shipping and price cuts are sometimes unpopular with investors, Bezos believes it builds customer satisfaction, loyalty, and frequency of purchase orders.

Amazon.com has established itself as an electronic marketplace by enabling merchants of all kinds to sell items on the site. It powers and operates retail Web sites for Target, the NBA, Timex, and Marks & Spencer. Amazon.com derives about 40 percent of its sales from its million-plus affiliates called "Associates," independent sellers or businesses that receive commissions for referring customers who then make a purchase at the Amazon.com site. Associates can refer consumers to Amazon.com through a variety of ways, including direct links and banner ads as well as Amazon Widgets, mini-applications that feature Amazon.com's wide selection of products.

Amazon.com also launched an affiliate product called aStore, which gives Associates the ability to create an Amazon-operated online store easily and without any programming knowledge. Amazon.com then supports these merchants by providing new tools for their Web site, offering access to Amazon.com's catalog of products, and handling all payments and payment security through its Web Services. Amazon.com can also "pick, pack and ship the products to the merchant's customers anytime and to any place" through its Fulfillment by Amazon (FBA). This essentially creates a virtual store for the third-party merchants with low risk and no additional cost.

One key to Amazon.com's success in all these different ventures was a willingness to invest in the latest Internet technology to make shopping online faster, easier, and more personally rewarding for its customers and third-party merchants. The company continues to invest 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 services meets the retailing needs of companies of virtually all sizes.

From the beginning, Bezos stated that even though he started as an online bookstore, he eventually wanted to sell everything through Amazon.com. Now, with more than 600 million annual visitors, the company continues to get closer to that goal with revolutionary products like the Kindle and cloud computing Web services.

Questions

1. Why has Amazon.com 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.com? Is cloud computing the right direction for the company? 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; Amazon.com, Amazon.com 2009 Annual Report.

Marketing Excellence

>>Costco

Costco's mission is "to continually provide our members with quality goods and services at the lowest possible prices." With nearly 60 million card-carrying members and over $71 billion in sales, Costco is now the largest warehouse club chain in the United States, the third largest retailer in the United States, and the ninth largest retailer in the world. Costco's success comes from years of building consumer loyalty through its dedicated merchandising and pricing strategy combined with no-frills, cost-cutting policies.

Costco's merchandising strategy focuses on offering a broad range of brand name and private label merchandise at extremely low prices. But unlike a grocery store that carries 40,000 SKUs or a Walmart that can carry up to 150,000, Costco carries approximately 4,000 SKUs—only the fastest-selling flavors, sizes, models, and colors from a single vendor in each category. This efficient product sourcing results in several outcomes: high volume of sales, rapid inventory turnover, extremely low prices, and better product manageability.

Costco buys its merchandise directly from the manufacturer. Products are shipped directly to Costco warehouses or to a depot, which reallocates the shipments to Costco warehouses within 24 hours. This process eliminates several steps such as using a distributor and other intermediaries, eliminating costs associated with storage, additional freight, and handling. At the warehouse, shipments are often taken directly to the floor, unwrapped, and left on the pallet, ready to sell.

Over the years, Costco has expanded its products and services from simple boxed items such as cereal and paper products to more complex items such as fresh produce and flowers, which must be displayed attractively and managed more closely. Today, it sells dairy, baked goods, seafood, clothing, books, computer software, vacuums, home appliances, electronics, jewelry, tires, art, wine, liquor, hot tubs, and furniture. Costco's services include pharmacies, optometrists, photo processors, food courts, and gas stations. The company's private label, Kirkland Signature, provides consumers with high-quality products at even more discounted prices than the comparable branded item. Kirkland Signature products range from diapers to bed sheets to coffee and makeup.

Of the 4,000 products sold, 3,000 are staples, found at Costco week after week, while the remaining 1,000 rotate as part of Costco's "treasure hunt." These special items are offered only temporarily and can be as exotic as Coach bags, Waterford crystal, and expensive jewelry. Costco believes its treasure hunt items create excitement and increase consumer loyalty, bringing back bargain hunters again and again.

Costco's pricing strategy is transparent: The company limits the markup of any branded item to 14 percent and any private-label item to 15 percent. (Supermarkets and department stores mark up items anywhere from 25 percent to 50 percent.) If a manufacturer's price is too high, the company will not restock the item. Costco's CEO, Jim Sinegal, explained, "The traditional retailer will say: 'I'm selling this for $10. I wonder whether I can get $10.50 or $11.' We say: 'We're selling it for $9. How do we get it down to $8?'"

Costco's cost savings tactics extend to its 560+ warehouse locations around the world. Most average 143,000 square feet with floor plans designed to optimize selling space, the handling of merchandise, and the control of inventory. Decor is simple: concrete floors, bare-bones signage, and product displays that consist of pallets right off the truck. Central skylights and day-lighting controls monitor energy usage, and Costco also saves by not supplying its own shopping bags. Instead, consumers use leftover boxes and crates stacked near cash registers to carry home their purchases. Costco spends little on marketing and promotions, except for the occasional direct mail to prospective new members and coupons to regular members.

The one place Costco does not cut costs is its employees. They are compensated well, and 85 percent have health insurance, more than twice the percentage at Target or Walmart. As a result, employee turnover and employee theft are extremely low. Costco's loyal consumer base appreciates the fact that its deep discounts come from strategic business planning and not at the workers' expense.

Costco's customers are not only loyal; many are affluent. The average household income is $74,000; 31 percent earn more than $100,000 per year. The majority of consumers tend to be businesses or large families with houses big enough to store bulk items. Membership at Costco starts at $50 a year and can be upgraded to Executive levels that provide additional benefits. Costco accepts only debit cards, cash, checks, and American Express, which charges Costco a very large interchange fee. While consumers need membership to shop at the warehouse locations, they can shop online without it. In 2008, 58 million consumers visited costco.com and nonmembers paid an addition 5 percent fee for any purchase.

Costco's success has come from focusing on a handful of business practices: sell a limited number of items, keep costs down, rely on high volume, pay workers well, require consumers to buy memberships, and target upscale consumers and business owners. This vision has led to many achievements, including ranking number 24 in the *Fortune* 500 and number 22 on *Fortune*'s Most Admired list. Costco also became the first company to grow from zero to $3 billion in sales in less than six years.

Questions

1. What is unique about Costco's channel management process? What components can other retailers borrow or implement?
2. Where can Costco improve? Should it offer more products or advertise more? Why or why not?

Sources: Matthew Boyle, "Why Costco Is So Addictive," *Fortune,* October 25, 2006; Steven Greenhouse, "How Costco Became the Anti-Walmart," *New York Times,* July 17, 2005; Costco, Costco.com 2009 Annual Report.

Chapter 16

In This Chapter, We Will Address the Following Questions

1. What major types of marketing intermediaries occupy this sector?
2. What marketing decisions do these marketing intermediaries make?
3. What are the major trends with marketing intermediaries?
4. What does the future hold for private label brands?

Cofounder Tony Hsieh has ensured that a strong customer-service culture is at the heart of operations at Zappos, the online footwear and accessories retailer.

Managing Retailing, Wholesaling, and Logistics

In the previous chapter, we examined marketing intermediaries from the viewpoint of manufacturers who wanted to build and manage marketing channels. In this chapter, we view these intermediaries—retailers, wholesalers, and logistical organizations—as requiring and forging their own marketing strategies in a rapidly changing world. Intermediaries also strive for marketing excellence and can reap the benefits like any other type of company.

Online footwear retailer Zappos was co-founded by Tony Hsieh in 1999 with superior customer service and an improved customer experience at the core of its corporate culture. With free shipping and returns, 24/7 customer service, and fast turnaround on a wide selection of 200,000 shoe styles from 1,200 makers, Zappos finds that three-fourths of purchases during any one day are by repeat customers. Unlike many other companies, Zappos has not outsourced its call centers; Hsieh sees that function as too important. In fact, Zappos empowers its customer service reps to solve problems. When a customer called to complain that a pair of boots was leaking after a year of use, the customer service rep sent out a new pair even though the company's policy is that only unworn shoes are returnable. Every employee has a chance each year to contribute a passage to the firm's Culture Book, about life at Zappos, and how each department implements superior customer service from selling to warehousing and delivery, to pricing and billing. Half the interview process for potential new hires is devoted to finding out whether they are sufficiently outgoing, open-minded, and creative to be a good cultural fit for the company. Bought by Amazon.com in 2009 for a reported $850 million but still run separately, the company now also sells clothing, handbags, and accessories. Thanks to its success, it even offers two-day, $4,000 seminars to business executives eager to learn about the secrets behind Zappos's unique corporate culture and approach to customer service.[1]

While innovative retailers such as Zappos, Sweden's H&M, Spain's Zara and Mango, and Britain's Topshop have thrived in recent years, others such as former U.S. stalwarts Gap, Home Depot, and Kmart have struggled. The more successful intermediaries use strategic planning, advanced information systems, and sophisticated marketing tools. They segment their markets, improve their market targeting and positioning, and aggressively pursue market expansion and diversification strategies. In this chapter, we consider marketing excellence in retailing, wholesaling, and logistics.

Retailing

Retailing includes all the activities in selling goods or services directly to final consumers for personal, nonbusiness use. A **retailer** or **retail store** is any business enterprise whose sales volume comes primarily from retailing.

Any organization selling to final consumers—whether it is a manufacturer, wholesaler, or retailer—is doing retailing. It doesn't matter *how* the goods or services are sold (in person, by mail, telephone, vending machine, or on the Internet) or *where* (in a store, on the street, or in the consumer's home).

After reviewing the different types of retailers and the new retail marketing environment, we examine the marketing decisions retailers make. The following are four examples of innovative retail organizations that have experienced market success in recent years.

Innovative Retail Organizations

Panera Bread. The $2.6 billion Panera Bread restaurant chain targets "food people who understand and respond to food or those on the verge of that" by selling fresh "real" food–and lots of warm bread—at full prices that customers are more than willing to pay. An unpretentious atmosphere—no table service, but no time limit—encourages customers to linger. The brand is seen as family-oriented but also sophisticated, offering an appealing combination of fresh, customizable, convenient, and affordable food.

Panera Bread appeals to food lovers of all kinds.

GameStop. Video game and entertainment software retailer GameStop has over 6,000 locations in malls and shopping strips all over the United States, making it highly convenient for customers. Staffed by hard-core gamers who like to connect with customers, GameStop boasts a trade-in policy that gives customers credit for an old game traded in for a new one.

Lumber Liquidators. Lumber Liquidators buys excess wood directly from lumber mills at a discount and stocks almost 350 kinds of hardwood flooring, about the same as Lowe's and Home Depot. It sells at lower prices because it keeps operating costs down by cutting out the middlemen and locating stores in inexpensive locations. Lumber Liquidators also knows a lot about its customers, such as the fact that shoppers who request product samples have a 30 percent likelihood of buying within a month, and that most tend to renovate one room at a time, not the entire home at once.

Net-a-Porter. London-based Net-a-Porter is an online luxury clothing and accessories retailer whose Web site combines the style of a fashion magazine with the thrill of shopping at a chic boutique. Seen by its loyal customers as an authoritative fashion voice, Net-a-Porter stocks over 300 international brands, such as Jimmy Choo, Alexander McQueen, Stella McCartney, Givenchy, Marc Jacobs, and others. The company ships to 170 countries and offers same-day delivery in London and Manhattan; the average order is $250.

Sources: Kate Rockwood, "Rising Dough, *Fast Company*, October 2009, pp. 69–71; Devin Leonard, "GameStop Racks Up the Points," *Fortune*, June 9, 2008, pp. 109–22; Helen Coster, "Hardwood Hero," *Forbes*, November 30, 2009, pp. 60–62; John Brodie, "The Amazon of Fashion," *Fortune*, September 14, 2009, pp. 86–95.

Types of Retailers

Consumers today can shop for goods and services at store retailers, nonstore retailers, and retail organizations.

STORE RETAILERS Perhaps the best-known type of store retailer is the department store. Japanese department stores such as Takashimaya and Mitsukoshi attract millions of shoppers each year and feature art galleries, restaurants, cooking classes, fitness clubs, and children's playgrounds. The most important types of major store retailers are summarized in Table 16.1.

Different formats of store retailers will have different competitive and price dynamics. Discount stores, for example, compete much more intensely with each other than other formats.[2] Retailers also meet widely different consumer preferences for service levels and specific services. Specifically, they position themselves as offering one of four levels of service:

1. ***Self-service***—Self-service is the cornerstone of all discount operations. Many customers are willing to carry out their own "locate-compare-select" process to save money.
2. ***Self-selection***—Customers find their own goods, although they can ask for assistance.
3. ***Limited service***—These retailers carry more shopping goods and services such as credit and merchandise-return privileges. Customers need more information and assistance.
4. ***Full service***—Salespeople are ready to assist in every phase of the "locate-compare-select" process. Customers who like to be waited on prefer this type of store. The high staffing cost, along with the higher proportion of specialty goods and slower-moving items and the many services, result in high-cost retailing.

TABLE 16.1 Major Types of Store Retailers
Specialty store: Narrow product line. The Limited, The Body Shop.
Department store: Several product lines. JCPenney, Bloomingdale's.
Supermarket: Large, low-cost, low-margin, high-volume, self-service store designed to meet total needs for food and household products. Kroger, Safeway.
Convenience store: Small store in residential area, often open 24/7, limited line of high-turnover convenience products plus takeout. 7-Eleven, Circle K.
Drug store: Prescription and pharmacies, health and beauty aids, other personal care, small durable, miscellaneous items. CVS, Walgreens.
Discount store: Standard or specialty merchandise; low-price, low-margin, high-volume stores. Walmart, Kmart.
Extreme value or hard-discount store: A more restricted merchandise mix than discount stores but at even lower prices. Aldi, Lidl, Dollar General, Family Dollar.
Off-price retailer: Leftover goods, overruns, irregular merchandise sold at less than retail. Factory outlets; independent off-price retailers such as TJ Maxx; warehouse clubs such as Costco.
Superstore: Huge selling space, routinely purchased food and household items, plus services (laundry, shoe repair, dry cleaning, check cashing). Category killer (deep assortment in one category) such as Staples; combination store such as Jewel-Osco; hypermarket (huge stores that combine supermarket, discount, and warehouse retailing) such as Carrefour in France and Meijer in the Netherlands.
Catalog showroom: Broad selection of high-markup, fast-moving, brand-name goods sold by catalog at a discount. Customers pick up merchandise at the store. Inside Edge Ski and Bike.

Source: Data from www.privatelabelmag.com.

NONSTORE RETAILING Although the overwhelming bulk of goods and services—97 percent—is sold through stores, *nonstore retailing* has been growing much faster than store retailing. Nonstore retailing falls into four major categories: direct selling, direct marketing (which includes telemarketing and Internet selling), automatic vending, and buying services:

1. ***Direct selling,*** also called *multilevel selling* and *network marketing*, is a multibillion-dollar industry, with hundreds of companies selling door-to-door or at home sales parties. Well-known in one-to-one selling are Avon, Electrolux, and Southwestern Company of Nashville (Bibles). Tupperware and Mary Kay Cosmetics are sold one-to-many: A salesperson goes to the home of a host who has invited friends; the salesperson demonstrates the products and takes orders. Pioneered by Amway, the multilevel (network) marketing sales system works by recruiting independent businesspeople who act as distributors. The distributor's compensation includes a percentage of sales made by those he or she recruits, as well as earnings on direct sales to customers. These direct-selling firms, now finding fewer consumers at home, are developing multidistribution strategies.
2. ***Direct marketing*** has roots in direct-mail and catalog marketing (Lands' End, L.L.Bean); it includes *telemarketing* (1-800-FLOWERS), *television direct-response marketing* (HSN, QVC), and *electronic shopping* (Amazon.com, Autobytel.com). As people become more accustomed to shopping on the Internet, they are ordering a greater variety of goods and services from a wider range of Web sites. In the United States, online sales were estimated to be $210 billion in 2009, with travel being the biggest category ($80 billion).[3]
3. ***Automatic vending*** offers a variety of merchandise, including impulse goods such as soft drinks, coffee, candy, newspapers, magazines, and other products such as hosiery, cosmetics, hot food, and paperbacks. Vending machines are found in factories, offices, large retail stores, gasoline stations, hotels, restaurants, and many other places. They offer 24-hour selling, self-service, and merchandise that is stocked to be fresh. Japan has the most vending machines per person—Coca-Cola has over 1 million machines there and annual vending sales of $50 billion—twice its U.S. figures.
4. ***Buying service*** is a storeless retailer serving a specific clientele—usually employees of large organizations—who are entitled to buy from a list of retailers that have agreed to give discounts in return for membership.

TABLE 16.2	Major Types of Corporate Retail Organizations
Corporate chain store: Two or more outlets owned and controlled, employing central buying and merchandising, and selling similar lines of merchandise. Gap, Pottery Barn.	
Voluntary chain: A wholesaler-sponsored group of independent retailers engaged in bulk buying and common merchandising. Independent Grocers Alliance (IGA).	
Retailer cooperative: Independent retailers using a central buying organization and joint promotion efforts. Associated Grocers, ACE Hardware.	
Consumer cooperative: A retail firm owned by its customers. Members contribute money to open their own store, vote on its policies, elect a group to manage it, and receive dividends. Local cooperative grocery stores can be found in many markets.	
Franchise organization: Contractual association between a franchisor and franchisees, popular in a number of product and service areas. McDonald's, Subway, Pizza Hut, Jiffy Lube, 7-Eleven.	
Merchandising conglomerate: A corporation that combines several diversified retailing lines and forms under central ownership, with some integration of distribution and management. Federated Department Stores renamed itself after one of its best-known retailers, Macy's, but also owns other retailers such as Bloomingdale's.	

CORPORATE RETAILING AND FRANCHISING Although many retail stores are independently owned, an increasing number are part of a **corporate retailing** organization. These organizations achieve economies of scale, greater purchasing power, wider brand recognition, and better-trained employees than independent stores can usually gain alone. The major types of corporate retailing—corporate chain stores, voluntary chains, retailer and consumer cooperatives, franchises, and merchandising conglomerates—are described in Table 16.2.

Franchise businesses such as Subway, Jiffy-Lube, Holiday Inn, Supercuts, and 7-Eleven account for more than $1 trillion of annual U.S. sales and roughly 40 percent of all retail transactions. One of every 12 U.S. retail businesses is a franchise establishment; these firms employ 1 in every 16 workers in the country.[4]

In a franchising system, individual *franchisees* are a tightly knit group of enterprises whose systematic operations are planned, directed, and controlled by the operation's innovator, called a *franchisor*. Franchises are distinguished by three characteristics:

1. The franchisor owns a trade or service mark and licenses it to franchisees in return for royalty payments.
2. The franchisee pays for the right to be part of the system. Start-up costs include rental and lease equipment and fixtures, and usually a regular license fee. McDonald's franchisees may invest as much as $1.6 million in total start-up costs and fees. The franchisee then pays McDonald's a certain percentage of sales plus a monthly rent.
3. The franchisor provides its franchisees with a system for doing business. McDonald's requires franchisees to attend "Hamburger University" in Oak Brook, Illinois, for two weeks to learn how to manage the business. Franchisees must follow certain procedures in buying materials.

Franchising benefits both franchisor and franchisee. Franchisors gain the motivation and hard work of employees who are entrepreneurs rather than "hired hands," the franchisees' familiarity with local communities and conditions, and the enormous purchasing power of being a franchisor. Franchisees benefit from buying into a business with a well-known and accepted brand name. They find it easier to borrow money for their business from financial institutions, and they receive support in areas ranging from marketing and advertising to site selection and staffing.

Franchisees do walk a fine line between independence and loyalty to the franchisor. Some franchisors are giving their franchisees freedom to run their own operations, from personalizing store names to adjusting offerings and price. Beef 'O' Brady's sports pub franchisees are allowed to set prices to reflect their local markets. Great Harvest Bread believes in a "freedom franchise" approach that encourages its franchisee bakers to create new items for their store menus and to share with other franchisees if they are successful.[5]

As part of their franchise agreement, new McDonald's franchisors must attend the company's Hamburger University for two weeks to learn how to properly manage their restaurants.

The New Retail Environment

With the onset of the recession in 2008, many retailers had to fundamentally reassess virtually everything they did. Some adopted a cautious, defensive response, cutting stock levels, slowing expansion, and discounting deeply. Others were more creative about managing inventory, adjusting product lines, and carefully avoiding overpromoting. For example, JCPenney held back 60 percent of inventory for the fall 2009 holiday season, compared to its usual 20 percent, to avoid having empty shelves and stock-outs on one hand and overflowing shelves and heavy discounting on the other hand. Some firms, such as the Container Store and Saks, lowered average prices; others, such as Gilt.com and Neiman Marcus, introduced selective and very short-term deep discounts. Restoration Hardware chose to move its furniture product lines more upscale.[6]

Although many of these short-term adjustments were likely to remain longer-term, a number of other long-term trends are also evident in the retail marketing environment. Here are some that are changing the way consumers buy and manufacturers and retailers compete (see Table 16.3 for a summary).

- ***New Retail Forms and Combinations.*** To better satisfy customers' need for convenience, a variety of new retail forms have emerged. Bookstores feature coffee shops. Gas stations include food stores. Loblaw's Supermarkets have fitness clubs. Shopping malls and bus and train stations have peddlers' carts in their aisles. Retailers are also experimenting with limited-time "pop-up" stores that let them promote brands to seasonal shoppers for a few weeks

TABLE 16.3	Recent Retail Developments
• New Retail Forms and Combinations	
• Growth of Intertype Competition	
• Competition between Store-Based and Nonstore-Based Retailing	
• Growth of Giant Retailers	
• Decline of Middle-Market Retailers	
• Growing Investment in Technology	
• Global Profile of Major Retailers	
• Growth of Shopper Marketing	