chapter 14

Marketing Channels and Supply-Chain Management

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OBJECTIVES

14-1 Describe the foundations of supply-chain management.

14-2 Explain the role and significance of marketing channels and supply chains.

14-3 Identify the intensity of market coverage.

14-4 Describe strategic issues in marketing channels, including leadership, cooperation, and conflict.

14-5 Explain physical distribution as being a part of supply-chain management.

14-6 Describe legal issues in channel management.

MARKETING INSIGHTS

Making H.Bloom's Business Bloom

Sonu Panda and Bryan Burkhart had never worked with flowers before they launched H.Bloom, a web-based floral business where data are as important as designs. Coming out of the software industry, the co-founders applied their technology know-how to streamlining the process of buying supplies and managing inventory and deliveries to meet customer demand. Their target market was customers (consumers and businesses) that wanted weekly deliveries of fresh floral arrangements.

According to Panda and Burkhart's research findings, 30 to 50 percent of the fresh flowers purchased by local florists spoil before they can be put into arrangements, which affect both pricing and profits. The entrepreneurs realized that they could make their new business bloom by drastically reducing spoilage, passing the savings along in the form of lower prices, and getting arrangements to customers quickly.

By the time H.Bloom opened its virtual storefront in 2010, the co-founders had sophisticated software ready to analyze sales history, project demand, and track minute-to-minute changes in the price, quality, and availability of hundreds of flowers offered by suppliers worldwide. Based on this information, H.Bloom's buyers know instantly when to switch to a different type of rose, for example, if it becomes available in abundance and the price drops by pennies per stem. The company also has software to plan the most efficient delivery routes, saving time and gas—and ensuring that customers can enjoy flowers as fresh as possible for as long as possible. Today, H.Bloom's spoilage is only 2 percent, and its annual revenues have blossomed to $5 million as it serves nine U.S. cities.[1]

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The **distribution** component of the marketing mix focuses on the decisions and activities involved in making products available to customers when and where they want to purchase them. H.Bloom uses sophisticated software to make data-driven distribution decisions and address issues. Choosing which channels of distribution to use is a major decision in the development of marketing strategies.

In this chapter, we focus on marketing channels and supply-chain management. First, we explore the concept of the supply chain and its various activities. Second, we elaborate on marketing channels and the need for intermediaries and the primary functions they perform. Next, we outline the types and characteristics of marketing channels, discuss how they are selected, and explore how marketers determine the appropriate intensity of market coverage for a product. We then examine the strategic channel issues of leadership, cooperation, and conflict. We also look at the role of physical distribution within the supply chain, including its objectives and basic functions. Finally, we look at several legal issues that affect channel management.

distribution The decisions and activities that make products available to customers when and where they want to purchase them

supply chain All the activities associated with the flow and transformation of products from raw materials through to the end customer

operations management The total set of managerial activities used by an organization to transform resource inputs into products, services, or both

logistics management Planning, implementing, and controlling the efficient and effective flow and storage of products and information from the point of origin to consumption to meet customers' needs and wants

supply management In its broadest form, refers to the processes that enable the progress of value from raw material to final customer and back to redesign and final disposition

supply-chain management A set of approaches used to integrate the functions of operations management, logistics management, supply management, and marketing channel management so products are produced and distributed in the right quantities, to the right locations, and at the right time

14-1 FOUNDATIONS OF THE SUPPLY CHAIN

An important function of distribution is the joint effort of all involved organizations to create an effective **supply chain**, which refers to all the activities associated with the flow and transformation of products from raw materials through to the end customer. It may help to think of the firms involved in a total distribution system as existing along a conceptual line, the combined impact of which results in an effective supply chain. A distribution system involves firms that are "upstream" in the channel (e.g., suppliers) and "downstream" (e.g., wholesalers and retailers) that work to serve customers and generate competitive advantage. Historically, marketing focused on only certain downstream supply-chain activities, but today marketing professionals are recognizing that they can secure marketplace advantages by effectively integrating activities along the entire length of the supply chain, including operations, logistics, sourcing, and marketing channels. Integrating these activities requires marketing managers to work with other managers in operations, logistics, and supply. **Operations management** is the total set of managerial activities used by an organization to transform resource inputs into goods, services, or both.[2] **Logistics management** involves planning, implementing, and controlling the efficient and effective flow and storage of products and information from the point of origin to consumption to meet customers' needs and wants. The costs of business logistics in the United States are huge, at nearly $1.3 trillion.[3] To put this in perspective, the entire U.S. annual gross domestic product (GDP) is around $15 trillion.[4] **Supply management** (e.g., purchasing, procurement, sourcing) in its broadest form refers to the processes that enable the progress of value from raw material to final customer and back to redesign and final disposition.

Supply-chain management is the set of approaches used to integrate the functions of operations management, logistics management, supply management, and marketing channel management so that products are produced and distributed in the right quantities, to the right locations, and at the right times. It includes activities like manufacturing, research, sales, advertising, and shipping. Supply-chain management involves all entities that facilitate product distribution and benefit from cooperative efforts, including suppliers of raw materials and other components to make goods and services, logistics and transportation firms, communication firms, and other firms that indirectly take part in marketing exchanges. The key tasks involved in supply-chain management are outlined in Table 14.1. Thus, the supply chain includes all entities that facilitate product distribution and benefit from cooperative efforts. Supply-chain managers must encourage cooperation between organizations in the supply chain and understand the trade-offs required to achieve optimal levels of efficiency and service.

Technology has improved supply-chain management capabilities globally. Advances in information technology, in particular, have created an almost seamless distribution process

Table 14.1 Key Tasks in Supply-Chain Management

Marketing Activities	Sample Activities
Operations management	Organizational and system-wide coordination of operations and partnerships to meet customers' product needs
Supply management	Sourcing of necessary resources, goods, and services from suppliers to support all supply-chain members
Logistics management	All activities designed to move the product through the marketing channel to the end user, including warehousing and inventory management
Channel management	All activities related to selling, service, and the development of long-term customer relationships

for matching inventory needs to manufacturer requirements in the upstream portion of the supply chain and to customers' requirements in the downstream portion of the chain. With integrated information sharing among chain members, firms can reduce costs, improve services, and provide increased value to the end customer. Information is a crucial component in operating supply chains efficiently and effectively.

Demand for innovative goods and services has increased and changed over time. Marketers have had to learn to be flexible and responsive to these demands to meet the fluctuating needs of customers by developing and distributing new products and modifying existing ones. Suppliers provide material and service inputs to meet customer needs in the upstream portion of the supply chain. Supply-chain managers can utilize data available through improved information technology to gain knowledge of a firm's customers, which helps to improve products in the downstream portion of the supply chain. Customers are also increasingly a knowledge source in developing the right product in the downstream portion of the supply chain. Firms now understand that managing the entire supply chain is critically important in ensuring that customers get the products when, where, and how they want them. In fact, supply-chain management is one of the industries poised for strong future growth because of the increasing importance of transporting the right products where they need to go safely and on time.[5] Amazon has set the gold standard for supply-chain management—offering customers nearly anything they can imagine at low prices, through a user-friendly website that features product reviews and ratings, perks like offering a variety of shipping options, and an easy return policy. Many companies have struggled to compete with and adapt to such a large and flexible competitor.[6] Amazon has even moved into selling and distributing everyday items, like toilet paper and cleaning supplies, by teaming up with suppliers all over the country to create a seamless distribution system.[7]

In ensuring an efficient supply chain, upstream firms provide direct or indirect input to make the product, and downstream firms are responsible for delivery of the product and after-market services to the ultimate customers. To ensure quality and customer satisfaction, firms must be involved in the management of every aspect of their supply chain, in close partnership with all involved upstream and downstream organizations. Supply-chain management is closely linked to a market orientation. All functional areas of business (marketing, management, production, finance, and information systems) overlap with and are involved in executing a customer orientation and participate in supply-chain management. If a firm has established a marketing strategy based on continuous customer-focused leadership, then supply-chain management will be driven by cooperation and strategic coordination to ensure customer satisfaction. Managers should recognize that supply-chain management is critical to fulfilling customer expectations and that it requires coordination with all areas of the business. Associating a market orientation with supply-chain management should lead to increased firm performance and competitiveness.[8]

14-2 THE ROLE OF MARKETING CHANNELS IN SUPPLY CHAINS

A **marketing channel** (also called a *channel of distribution* or *distribution channel*) is a group of individuals and organizations that direct the flow of products from producers to customers within the supply chain. The major role of marketing channels is to make products available at the right time at the right place in the right quantities. This is achieved by creating synergy among operations management, logistics management, and supply management. Providing customer satisfaction should be the driving force behind marketing channel decisions. Buyers' needs and behavior are, therefore, important concerns of channel members.

Some marketing channels are direct, meaning that the product goes directly from the producer to the customer. For instance, when you order pears online from Harry & David, the product is sent from the manufacturer to the customer. Most channels, however, have one or more **marketing intermediaries** that link producers to other intermediaries or to ultimate consumers through contractual arrangements or through the purchase and reselling of products. Marketing intermediaries perform the activities described in Table 14.2. They also play key roles in customer relationship management, not only through their distribution activities but also by maintaining databases and information systems to help all members of the marketing channel maintain effective customer relationships. For example, MercuryGate provides transportation management software to firms to streamline logistics. The company also works directly with shippers and third-party logistics companies and brokers to ensure that its customers have effective and efficient supply chains by using analytics and a robust information database pulled from its many clients. Its methods work—as its clients, such as Walmart and Siemens, are known for their exemplary supply-chain management.[9]

marketing channel A group of individuals and organizations that direct the flow of products from producers to customers within the supply chain

marketing intermediaries Middlemen that link producers to other intermediaries or ultimate consumers through contractual arrangements or through the purchase and resale of products

Wholesalers and retailers are examples of intermediaries. Wholesalers buy and resell products to other wholesalers, retailers, and industrial customers. Retailers purchase products and resell them to end consumers. Consider your local supermarket, which probably purchased the Advil on its shelves from a wholesaler. The wholesaler purchased that pain medicine, along with other over-the-counter and prescription drugs, from manufacturers like McNeil Consumer Healthcare. Chapter 15 discusses the functions of wholesalers and retailers in marketing channels in detail.

Table 14.2 Marketing Channel Activities Performed by Intermediaries

Marketing Activities	Sample Activities
Marketing information	Analyze sales data and other information in databases and information systems. Perform or commission marketing research.
Marketing management	Establish strategic and tactical plans for developing customer relationships and organizational productivity.
Facilitating exchanges	Choose product assortments that match the needs of customers. Cooperate with channel members to develop partnerships.
Promotion	Set promotional objectives. Coordinate advertising, personal selling, sales promotion, publicity, and packaging.
Price	Establish pricing policies and terms of sales.
Physical distribution	Manage transportation, warehousing, materials handling, inventory control, and communication.

Supply-chain management should begin with a focus on the customer, who is the ultimate consumer and whose satisfaction should be the goal of all the efforts of channel members. Cooperation between channel members should improve customer satisfaction while also increasing coordination, reducing costs, and increasing profits. According to Deloitte Consulting, up to 70 percent of a firm's cost base can be traced back to its supply chain.[10] For this reason, firms are usually interested in taking steps that allow them to reduce waste, such as cutting down on energy requirements. Improving coordination between supply-chain members can help achieve fewer wasted resources and greater speed, and lead to increased environmental sustainability—which can improve a firm's image in the eyes of many consumers.[11] When the buyer, the seller, marketing intermediaries, and facilitating agencies work together, the cooperative relationship results in compromise and adjustments that meet customers' needs regarding delivery, scheduling, packaging, or other requirements.

Each supply-chain member requires information from other channel members. For instance, suppliers need order and forecast information from the manufacturer. They may also need availability information from their own suppliers. Customer relationship management (CRM) systems exploit the information in supply-chain partners' information systems and make it available for easy reference. CRM systems can help all channel members make better marketing strategy decisions that develop and sustain desirable customer relationships. Companies now offer online programs that integrate business data into a social networking site format. Tibbr and Yammer are two such programs. By inputting all data into a single, easy-to-use online system, businesses can achieve greater efficiencies and improve their CRM.[12]

14-2a The Significance of Marketing Channels

Although it is not necessary to make marketing channel decisions before other marketing decisions, they can have a strong influence on the other elements of the marketing mix (i.e., product, promotion, and pricing). Channel decisions are critical because they determine a product's market presence and accessibility. Without marketing channel operations that reach the right customers at the right time, even the best goods and services will not be successful. For example, in spite of spending massive amounts on marketing efforts, Motorola's Moto X smartphone was widely deemed a failure when marketing channel decisions failed to ensure that elements of the marketing mix were reaching the correct target market. Experts attributed the flop to failing to target the best market, positioning it as a high-end phone and making it available exclusively in the United States. If Motorola had chosen global marketing channels, especially in countries where the smartphone market is not yet mature, the Moto X might have been more successful.[13]

Marketing channel decisions have strategic significance because they generally entail long-term commitments among a variety of firms (e.g., suppliers, logistics providers, and operations firms). Furthermore, it is the least flexible component of the marketing mix. Once a firm commits to a distribution channel, it is difficult to change. Marketing channels serve many functions, including creating utility and facilitating exchange efficiencies. Although some of these functions may be performed by a single channel member, most functions are accomplished through both independent and joint efforts of channel members.

Marketing Channels Create Utility

Marketing channels create four types of utility: time, place, possession, and form. *Time utility* is having products available when the customer wants them. Services like Netflix allow customers to watch a movie whenever they want. *Place utility* is making products available in locations where customers wish to purchase them. For example, Zappos allows customers to shop for shoes and accessories anywhere they have access to a mobile device and an Internet connection. *Possession utility* means that the customer has access to the product to use or to store for future use. Possession utility can occur through ownership or through arrangements that give the customer the right to use the product, such as a lease or rental agreement. Channel members sometimes create *form utility* by assembling, preparing, or otherwise refining the product to suit individual customer needs.

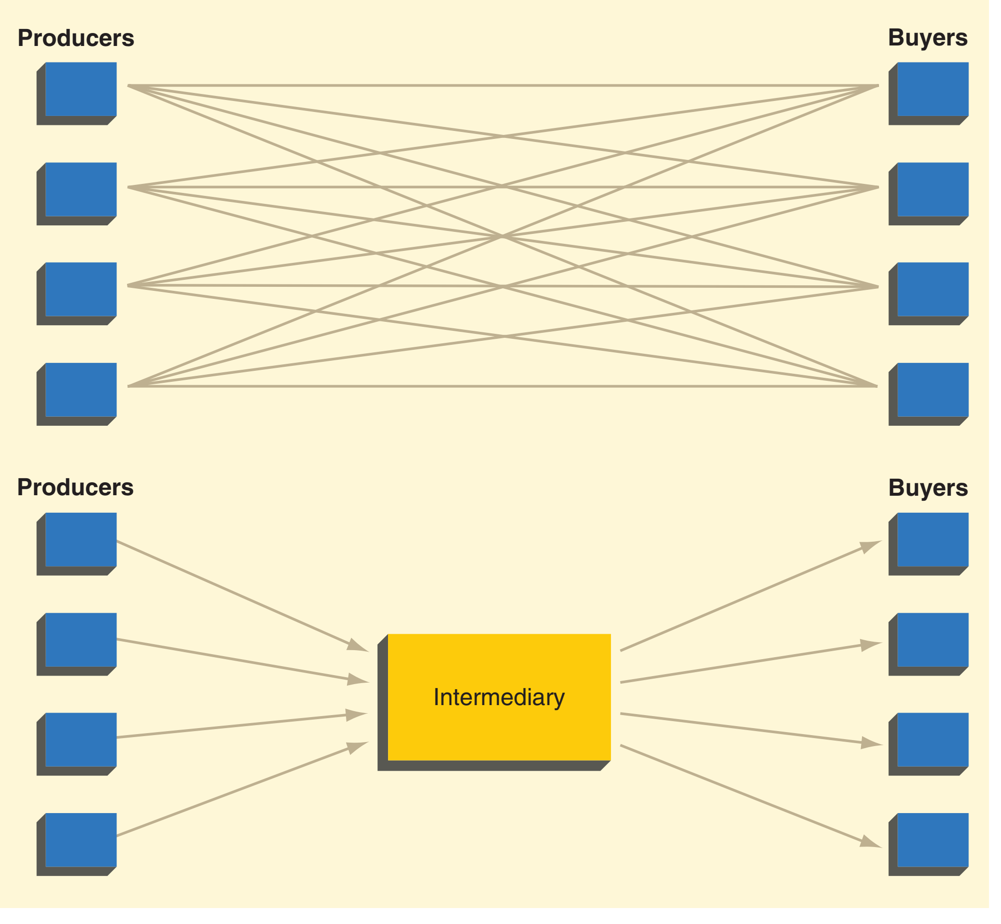
Marketing Channels Facilitate Exchange Efficiencies

Even if producers and buyers are located in the same city, there are costs associated with exchanges. Marketing intermediaries can reduce the costs of exchanges by performing certain services or functions efficiently. As Figure 14.1 shows, when four buyers seek products from four producers, 16 separate transactions are possible. If one intermediary serves both producers and buyers, the number of possible transactions is cut in half. Intermediaries are specialists in facilitating exchanges. They provide valuable assistance because of their access to and control over important resources used in the proper functioning of marketing channels. Many firms exist to assist firms with creating supply-chain efficiencies. Take a look at the advertisement for NFI. It shows a man dwarfed by a huge stack of shipping containers, which captures the feeling of being overwhelmed by the task of transporting their goods efficiently and safely—a common feeling among many firms as they grow. Firms like NFI have expert knowledge and have developed distribution networks that can help firms to create supply-chain efficiencies.

Nevertheless, the press, consumers, public officials, and even other marketers freely criticize intermediaries, especially wholesalers. Critics accuse wholesalers of being inefficient and adding to costs. Buyers often think that making the distribution channel as short as possible will decrease the prices for products, but this is not the case.

Critics who suggest that eliminating wholesalers will lower prices for customers fail to recognize that this would not eliminate the need for the services the wholesalers provide. Although wholesalers can be eliminated, their functions cannot. Other channel members would have to perform those functions, perhaps not as efficiently, and customers still would

Figure 14.1 **Efficiency in Exchanges Provided by an Intermediary**



have to pay for them. In addition, all producers would deal directly with retailers or customers, meaning that every producer would have to keep voluminous records and hire sufficient personnel to deal with a multitude of customers. In the end, customers might end up paying a great deal more for products because prices would reflect the costs of an inefficient distribution channel. To mitigate criticisms, wholesalers should only perform the marketing activities that are desired, and they must strive to be as efficient and customer-focused as possible.

14-2b Types of Marketing Channels

Because marketing channels that are appropriate for one product may be less suitable for others, many different distribution paths have been developed. The various marketing channels can be classified generally as channels for consumer products and channels for business products.

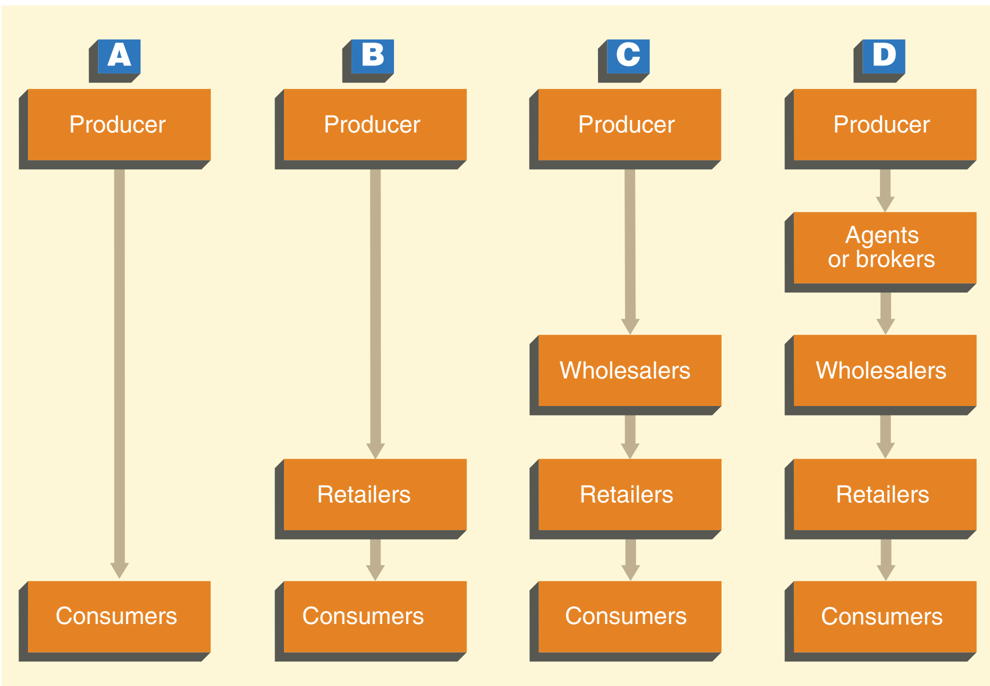
Channels for Consumer Products

Figure 14.2 illustrates several channels used in the distribution of consumer products. Channel A depicts the direct movement of products from producer to consumers. For instance, a haircut received at a barber shop moves through channel A because there is no intermediary between the person performing the service and the one receiving it. Direct marketing via the Internet has become a critically important part of some companies' distribution strategies, often as a complement to selling products in traditional

NFI

Supply-Chain Efficiencies
Logistics firms such as NFI can help businesses to create supply-chain efficiencies, distributing their goods quickly and affordably.

Figure 14.2 Typical Marketing Channels for Consumer Products



retail stores. A firm must evaluate the benefits of going direct versus the transaction costs involved in using intermediaries.

Channel B, which moves goods from the producer to a retailer and then to customers, is a frequent choice of large retailers because it allows them to buy in quantity from manufacturers. Retailers like Kmart and Walmart sell many items that were purchased directly from producers. New automobiles and new college textbooks are also sold through this type of marketing channel.

Channel C is a common distribution channel for consumer products. It takes goods from the producer to a wholesaler, then to a retailer, and finally to consumers. It is a practical option for producers that sell to hundreds of thousands of customers through thousands of retailers. Some home appliances, hardware, and many convenience goods are marketed through this type of channel. Consider the number of retailers marketing KitchenAid appliances. It would be extremely difficult, if not impossible, for KitchenAid to deal directly with each retailer that sells its brand.

Channel D, wherein goods pass from producer, to agents, to wholesalers, to retailers, and finally to consumers, is used frequently for products intended for mass distribution, such as processed foods. Consequently, to place its Wheat Thins crackers in specific retail outlets, supply-chain managers at Nabisco may hire an agent (or a food broker) to sell the crackers to wholesalers. Wholesalers then sell the Wheat Thins to supermarkets, vending-machine operators, and convenience stores.

Contrary to what you might think, a long channel may actually be the most efficient distribution channel for some goods. When several channel intermediaries perform specialized functions, costs are likely to be lower than when one channel member tries to perform them all. Efficiencies arise when firms that specialize in certain elements of producing a product or moving it through the channel are more effective at performing specialized tasks than the manufacturer. This results in added value to customers and reduced costs throughout the distribution channel.

Channels for Business Products

Figure 14.3 shows four of the most common channels for business products. As with consumer products, manufacturers of business products sometimes work with more than one level of wholesaler.

Entrepreneurship in Marketing

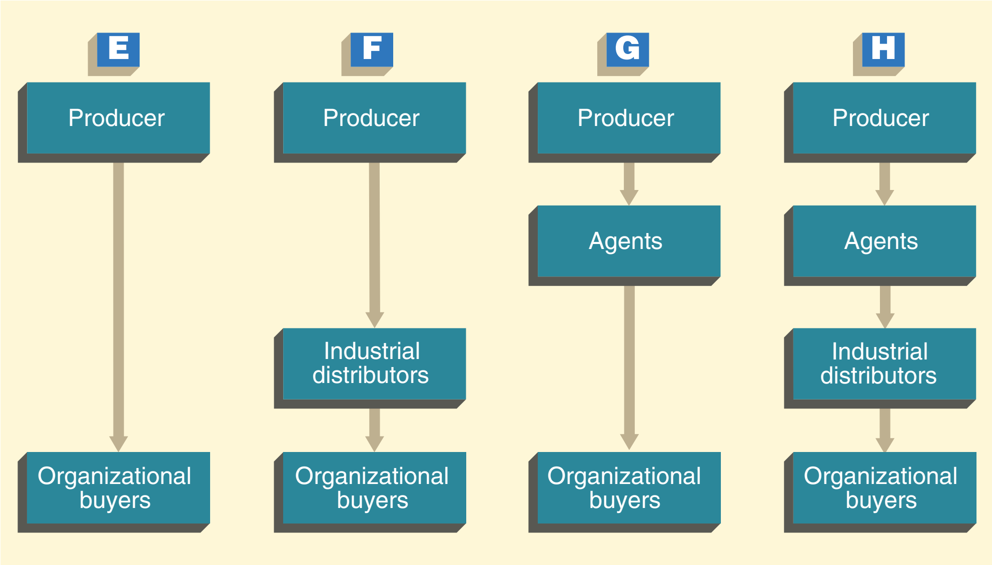
Van Leeuwen Artisan Ice Cream

Entrepreneurs: Pete Van Leeuwen, Ben Van Leeuwen, and Laura O'Neill
Business: Van Leeuwen Artisan Ice Cream
Founded: 2008, New York City
Success: Van Leeuwen Artisan Ice Cream has expanded from two ice-cream trucks to six trucks and three stores within 5 years.

The gourmet food-truck boom was in its infancy when the Van Leeuwen brothers and Laura O'Neill came up with the idea of selling super-premium ice cream from old-fashioned ice-cream trucks roaming New York City. With money invested by family and friends, the entrepreneurs bought two 1950s ice-cream trucks, outfitted them for a retro look, and cooked up 10 ice-cream flavors from fresh ingredients.

During the first year, the brothers drove the trucks 7 days a week, parking and selling ice cream in busy neighborhoods. Word spread and the lines grew longer and longer—just as more competitors began discovering the low-overhead business potential of food trucks. Over time, Van Leeuwen added new products and gained such a loyal following that the company could afford to open stores and buy additional trucks. Today, the trucks are hired to serve at weddings and other special events, and the stores are ringing up solid profits for the trio of entrepreneurs.[a]

Figure 14.3 **Typical Marketing Channels for Business Products**



Channel E illustrates the direct channel for business products. In contrast to consumer goods, business products, especially expensive equipment, are most likely to be sold through direct channels. Business customers prefer to communicate directly with producers, especially when expensive or technically complex products are involved. For instance, business buyers of Xerox products not only receive devices and equipment, but ongoing maintenance, technical support, and data analytics. Xerox has moved from being a company known for its copiers to a creative powerhouse that delivers a variety of solutions to its clients. Service through direct channels is a big part of Xerox's success. It digitally collects ongoing information from many of the products it sells to companies and performs preemptive repairs on machines it senses are about to malfunction. This level of service would be impossible through an intermediary.[14]

In channel F, an industrial distributor facilitates exchanges between the producer and the customer. An **industrial distributor** is an independent business that takes title to products and carries inventories. Industrial distributors usually sell standardized items, such as maintenance supplies, production tools, and small operating equipment. Some industrial distributors carry a wide variety of product lines. Applied Industrial Technologies Inc., for instance, carries millions of products from more than 4,000 manufacturers and works with a wide variety of companies from small janitorial services companies to Boeing.[15] Other industrial distributors specialize in one or a small number of lines. Industrial distributors carry an increasing percentage of business products. Overall, these distributors can be most effective when a product has broad market appeal, is easily stocked and serviced, is sold in small quantities, and is needed on demand to avoid high losses.

Industrial distributors offer sellers several advantages. They can perform the needed selling activities in local markets at a relatively low cost to a manufacturer and reduce a producer's financial burden by providing customers with credit services. Also, because industrial distributors usually maintain close relationships with their customers, they are aware of local needs and can pass on market information to producers. By holding adequate inventories in local markets, industrial distributors reduce producers' capital requirements.

Using industrial distributors has several disadvantages. They may be difficult to control because they are independent firms. They often stock competing brands, so a producer cannot depend on them to sell its brand aggressively. Furthermore, industrial distributors incur expenses from maintaining inventories and are less likely to handle bulky or slow-selling items, or items that need specialized facilities or extraordinary selling efforts. In some cases, industrial distributors lack the specialized knowledge necessary to sell and service technical products.

industrial distributor
An independent business organization that takes title to industrial products and carries inventories

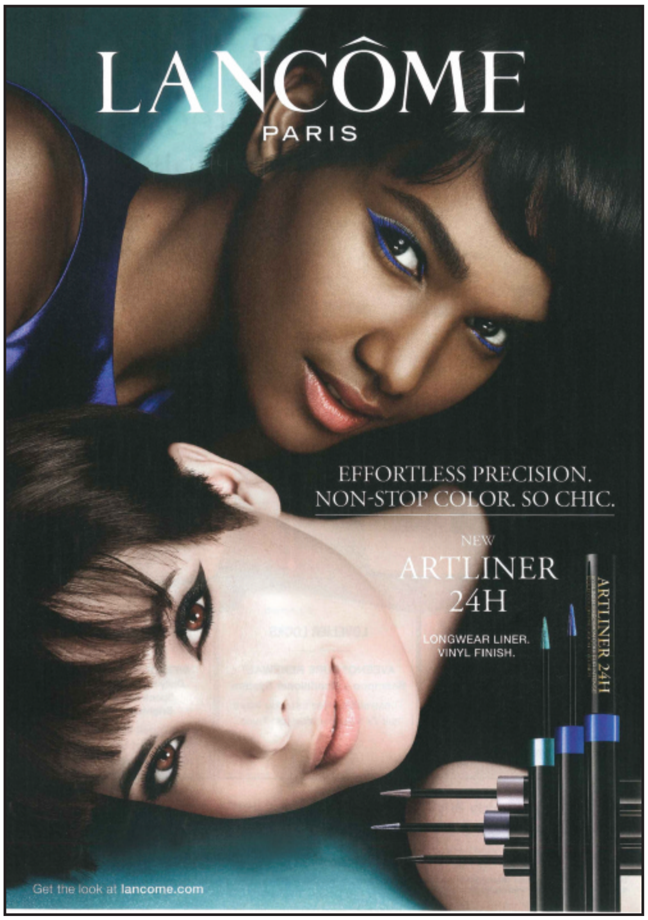
The third channel for business products, channel G, employs a *manufacturers' agent,* an independent businessperson who sells complementary products of several producers in assigned territories and is compensated through commissions. Unlike an industrial distributor, a manufacturers' agent does not acquire title to the products and usually does not take possession. Acting as a salesperson on behalf of the producers, a manufacturers' agent has little or no latitude in negotiating prices or sales terms.

Using manufacturers' agents can benefit an organizational marketer. They usually possess considerable technical and market information and have an established set of customers. For an organizational seller with highly seasonal demand, a manufacturers' agent can be an asset because the seller does not have to support a year-round sales force. The fact that manufacturers' agents are typically paid on a commission basis may also be an economical alternative for a firm that has highly limited resources and cannot afford a full-time sales force.

The use of manufacturers' agents also has drawbacks. The seller has little control over the actions of manufacturers' agents. Because they work on commission, manufacturers' agents prefer to concentrate on larger accounts. They are often reluctant to spend time following up with customers after the sale, putting forth special selling efforts, or providing sellers with market information because they are not compensated for these activities and they reduce the amount of productive selling time. Because they rarely maintain inventories, manufacturers' agents have a limited ability to provide customers with parts or repair services quickly.

dual distribution The use of two or more marketing channels to distribute the same products to the same target market

Finally, channel H includes both a manufacturers' agent and an industrial distributor. This channel may be appropriate when the producer wishes to cover a large geographic area, but maintains no sales force due to highly seasonal demand or because it cannot afford one. This channel can also be useful for a business marketer that wants to enter a new geographic market without expanding its sales force.



L'Oréal

Dual Distribution
Many firms, including Lancôme, use dual distribution—meaning products are targeted at the same group of consumers via multiple channels. In this case, eyeliner is made available to consumers in department stores and online.

Multiple Marketing Channels and Channel Alliances

To reach diverse target markets, manufacturers may use several marketing channels simultaneously, with each channel involving a different group of intermediaries. A manufacturer often uses multiple channels when the same product is directed to both consumers and business customers. For example, when Heinz markets ketchup for household use, the product is sold to supermarkets through grocery wholesalers or, in some cases, directly to retailers. Ketchup sold to restaurants or institutions, however, follows a different distribution channel.

In some instances, a producer may prefer **dual distribution**, the use of two or more marketing channels to distribute the same products to the same target market. For instance, Kellogg sells its cereals directly to large retail grocery chains (channel B) and food wholesalers that, in turn, sell the cereals to retailers (channel C). Another example of dual distribution is a firm that sells products through retail outlets and its own mail-order catalog or website. Many producers, which previously had sold to wholesalers and retailers, now feature online stores on their company webpages that ship directly from producer to consumer. This is an example of dual distribution because the products are marketed to the same customers through different channels, one involving intermediaries and one direct. Even marketers for makeup, such as the Lancôme eyeliner featured in the advertisement, employ dual distribution. This product is available in department stores, but customers can also purchase it on the producer's website, which is featured prominently on the advertisement. As an extra enticement to shop using the website, the lower left-hand corner of the advertisement tells customers to go to the company website to access makeup tutorials.

A **strategic channel alliance** exists when the products of one organization are distributed through the marketing channels of another. The products of the two firms are often similar with respect to target markets or uses, but they are not direct competitors. A brand of bottled water might be distributed through a marketing channel for soft drinks, or a cereal producer in the United States might form a strategic channel alliance with a European food processor to facilitate international distribution. Such alliances can provide benefits for both the organization that owns the marketing channel and the company whose brand is being distributed through the channel.

14-2c Selecting Marketing Channels

Selecting appropriate marketing channels is important because they are difficult to change once chosen. Although the process varies across organizations, channel selection decisions are usually affected significantly by one or more of the following factors: customer characteristics, product attributes, type of organization, competition, marketing environmental forces, and characteristics of intermediaries (see Figure 14.4).

Customer Characteristics

Marketing managers must consider the characteristics of target market members in channel selection. As we have already seen, the channels that are appropriate for consumers are different from those for business customers. Because of variations in product use, product complexity,

strategic channel alliance
An agreement whereby the products of one organization are distributed through the marketing channels of another

Figure 14.4 **Selecting Marketing Channels**

consumption levels, and need for services, firms develop different marketing strategies for each group. Business customers often prefer to deal directly with producers (or very knowledgeable channel intermediaries such as industrial distributors), especially for highly technical or expensive products, such as mainframe computers, jet airplanes, or heavy machinery that require strict specifications and technical assistance. Businesses also frequently buy in large quantities.

Consumers, on the other hand, generally buy limited quantities of a product, purchase from retailers, and often do not mind limited customer service. When customers are concentrated in a small geographic area, a direct channel may be best, but when many customers are spread across an entire state or nation, distribution through multiple intermediaries is likely to be more efficient.

Product Attributes

The attributes of the product can have a strong influence on the choice of marketing channels. Marketers of complex and expensive products (like automobiles) will likely employ short channels, as will marketers of perishable products (such as dairy and produce). Less-expensive standardized products with long shelf lives, like soft drinks and canned goods, can go through longer channels with many intermediaries. Fragile products that require special handling are likely to be distributed through short channels to minimize the amount of handling and risk of damage. Firms that desire to convey an exclusive image for their products may wish to limit the number of outlets available.

Type of Organization

The characteristics of the organization will have a great impact on the distribution channels chosen. Owing to their size, larger firms are in a better position to deal with vendors or other channel members. They are also likely to have more distribution centers, which reduce delivery times to customers. Large companies can also use an extensive product mix as a competitive tool. A smaller company that uses regional or local channel members, on the other hand, might be in a strong position to cater its marketing mix to serve customers in that particular area, compared with a larger and less-flexible organization. However, smaller firms may not have the resources to develop their own sales force, ship their products long distances, maintain a large inventory, or extend credit. In such cases, they might consider including other channel members that have the resources to provide these services to customers.

Competition

Competition is another important factor for supply-chain managers to consider. The success or failure of a competitor's marketing channel may encourage or dissuade an organization from taking a similar approach. In a highly competitive market, it is important for a company to maintain low costs so it can offer lower prices than its competitors if necessary to maintain a competitive advantage.

Environmental Forces

Environmental forces can play a role in channel selection. Adverse economic conditions might force an organization to use a low-cost channel, even though it reduces customer satisfaction. In contrast, a growing economy may allow a company to choose a channel that previously had been too costly. New technology might allow an organization to add to or modify its channel strategy in beneficial ways, such as adding online retailing or dealing with intermediaries in more direct ways.

The introduction of new technology might cause an organization to add or modify its channel strategy. For instance, many marketers in a variety of industries are finding that it is valuable to maintain online social networking accounts to keep customers up-to-date on new products, offers, and events.

Government regulations can also affect channel selection. As labor and environmental regulations change, an organization may be forced to modify its existing distribution channel structure to comply with new laws. Firms might choose to enact the changes before they are mandated in order to appear proactive. International governmental regulations can complicate the supply chain a great deal, as laws vary from country to country and businesses must make sure they comply with local regulations. Walmart, the largest retailer in the world, decided to suspend retail operations in India, a potentially huge market, because of difficulties in navigating international rules on foreign investment in that country. For smaller companies with fewer resources to devote to negotiating difficult international environments, the challenges can be even greater.[16]

Characteristics of Intermediaries

When an organization believes that an intermediary is not promoting its products adequately or does not offer the correct mix of services, it may reconsider its channel choices. In these instances, the company may choose another channel member to handle its products, it may select a new intermediary, or it might choose to eliminate intermediaries altogether and perform the functions itself.

14-3 INTENSITY OF MARKET COVERAGE

In addition to deciding which marketing channels to use to distribute a product, marketers must determine the appropriate intensity of coverage—that is, the number and kinds of outlets in which a product will be sold. This decision depends on the characteristics of the product and the target market. To achieve the desired intensity of market coverage, distribution must correspond to behavior patterns of buyers. In Chapter 11, we divided consumer products into four categories—convenience, shopping, specialty, and unsought—according to how consumers make purchases. In considering products for purchase, consumers take into account such factors as replacement rate, product adjustment (services), duration of consumption, and time required to find the product.[17] These variables directly affect the intensity of market coverage. As shown in Figure 14.5, the three major levels of market coverage are intensive, selective, and exclusive distribution.

Figure 14.5 Intensity of Market Coverage

14-3a Intensive Distribution

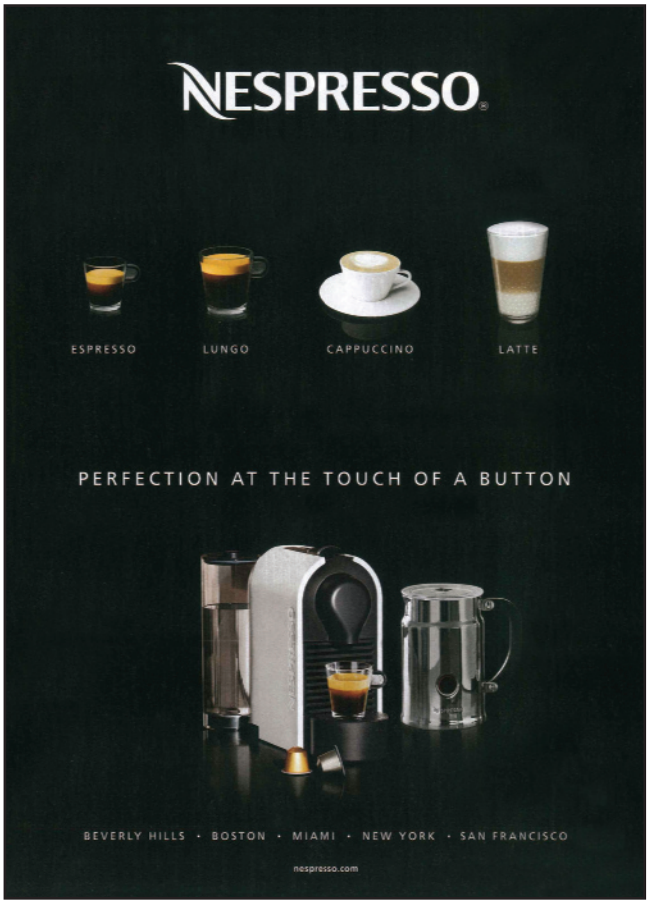
Intensive distribution uses all available outlets for distributing a product. Intensive distribution is appropriate for products that have a high replacement rate, require almost no service, and are bought based on price cues. Most convenience products like bread, chewing gum, soft drinks, and newspapers are marketed through intensive distribution. Multiple channels may be used to sell through all possible outlets. For example, goods such as soft drinks, snacks, laundry detergent, and pain relievers are available at convenience stores, service stations, supermarkets, discount stores, and other types of retailers. To satisfy consumers seeking to buy these products, they must be available at a store nearby and be obtained with minimal search time. Consumers want to be able to buy these products wherever it is most convenient to them at the lowest price possible while maintaining a reliable level of quality.

intensive distribution Using all available outlets to distribute a product

selective distribution Using only some available outlets in an area to distribute a product

exclusive distribution Using a single outlet in a fairly large geographic area to distribute a product

Sales of low-cost convenience products may be directly related to product availability. Fans of Sriracha brand hot sauce, for instance, were faced with shortages when the California Department of Public Health began to enforce stricter guidelines, halting shipments of the sauce for 30 days.[18] The lack of product availability where consumers demanded it resulted in lost revenues for the company when consumers could not easily find the product in its usual outlets. Companies like Procter & Gamble that produce consumer packaged items rely on intensive distribution for many of their products (e.g., soaps, detergents, food and juice products, and personal-care products) because consumers want ready availability.



Nestle Nespresso

Selective Distribution
Nespresso brand espresso makers and coffees are distributed selectively. Salespeople will be knowledgeable and willing to assist a customer in making a selection.

14-3b Selective Distribution

Selective distribution uses only some available outlets in an area to distribute a product. Selective distribution is appropriate for shopping products, which include durable goods like televisions or computers. Shopping products are more expensive than convenience goods, and consumers are willing to spend more time and possibly visit several retail outlets to compare prices, designs, styles, and other features.

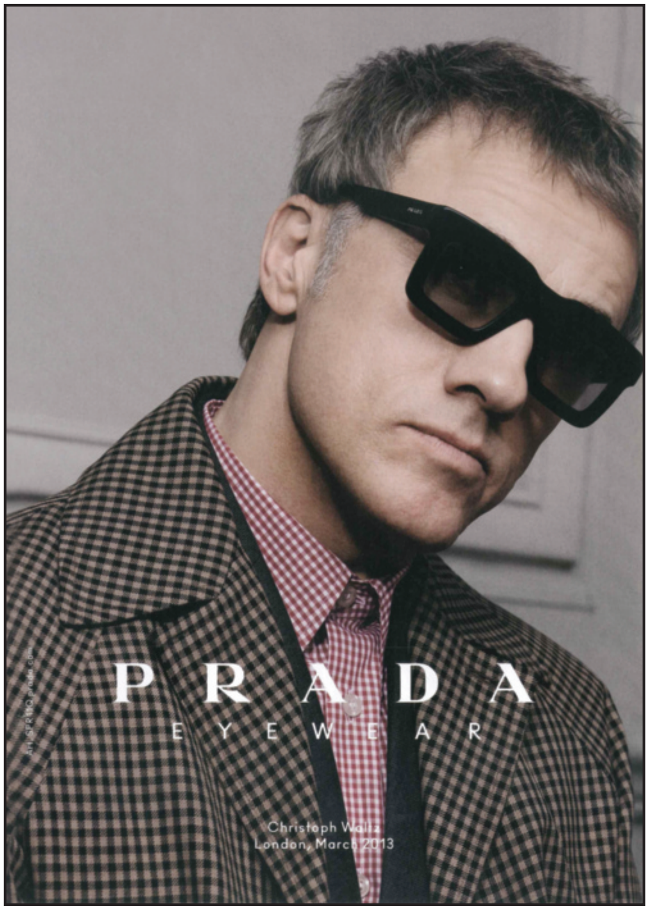
Selective distribution is desirable when a special effort, such as customer service from a channel member, is important to customers. Shopping products require differentiation at the point of purchase. Selective distribution is often used to motivate retailers to provide adequate service. Dealers can offer higher-quality customer service when products are distributed selectively. Consider the advertisement for Nespresso espresso machines and coffees. Nespresso is a moderately high-end brand of coffeemaker that is distributed selectively. Nespresso products are available at dedicated stores and at department stores, such as Macys. This advertisement seeks to cultivate a high-end image by focusing on the clean lines of the machine and the fancy coffee shop drinks that customers can create. When shopping for Nespresso products, salespeople will be able to assist customers and will be knowledgeable about the products. Most perfumes and colognes and some cosmetics are marketed using selective distribution in order to maintain a particular image.

14-3c Exclusive Distribution

Exclusive distribution uses only one outlet in a relatively large geographic area. This method is suitable for products purchased infrequently, consumed over a long period of time, or that require a high level of customer service or information. It is also used for expensive, high-quality products with high profit margins, such as Porsche, BMW, and other luxury automobiles. It is not appropriate for convenience products and many shopping products because an insufficient number of units would be sold to generate an acceptable level of profits on account of those products' lower profit margins.

Exclusive distribution is often used as an incentive to sellers when only a limited market is available for products. Consider Patek Philippe watches that may sell for $10,000 or more. These watches, like luxury automobiles, are available in only a few select locations. Prada, featured in the advertisement, is another brand distributed exclusively. Prada is only available in flagship stores and very exclusive outlets, all located in large cities or resort areas. Items can retail for thousands of dollars, and the brand is frequently worn as a status symbol. This advertisement underscores the exclusive and elite nature of the brand by featuring a famous European actor, Christoph Waltz. A producer using exclusive distribution expects dealers to carry a complete inventory, train personnel to ensure a high level of product knowledge and quality customer service, and participate in promotional programs.

Some products are appropriate for exclusive distribution when first introduced, but as competitors enter the market and the product moves through its life cycle, other types of market coverage and distribution channels become necessary. A problem that can arise with exclusive (and selective) distribution is that unauthorized resellers acquire and sell products or counterfeits, violating the agreement between a manufacturer and its exclusive authorized dealers.



Prada

Exclusive Distribution
Prada uses exclusive distribution, only selling products at flagship stores in large cities or wealthy resort areas.

14-4 STRATEGIC ISSUES IN MARKETING CHANNELS

To maintain customer satisfaction and an effective supply chain, managers must retain a strategic focus on certain competitive priorities, including developing channel leadership, fostering cooperation between channel members, managing channel conflict, and possibly consolidating marketing channels through channel integration.

14-4a Competitive Priorities in Marketing Channels

Increasingly, firms have become aware that supply chains can be a source of competitive advantage and a means of maintaining a strong market orientation because supply-chain decisions cut across all functional areas of business. Building the most effective and efficient supply chain can sustain a business and help it to use resources effectively and be more efficient. Many well-known firms, including Amazon, Dell, FedEx, Toyota, and Walmart, owe much of their success to outmaneuvering rivals with unique supply-chain capabilities. Many countries offer firms opportunities to create an effective and efficient supply chain to support the development of competitive national industries. Although developed nations like Germany, the United States, and Canada remain among the most competitive manufacturing countries, China has ranked number one on Deloitte's annual survey of global manufacturing competitiveness for years, indicating the country's superior capabilities to produce goods at a low price and efficiently distribute them.[19] India, South Korea, and Taiwan have risen to prominence as well.

To unlock the potential of a supply chain, activities must be integrated so that all functions are coordinated into an effective system. Supply chains driven by firm-established goals focus on the "competitive priorities" of speed, quality, cost, or flexibility as the performance objective. Managers must remember, however, to keep a holistic view of the supply chain so that goals such as "speed" or "cost" do not result in dissatisfied or underpaid workers or other such abuses in factories. This should be a particular concern among firms that use international manufacturers because it can be more difficult to monitor working conditions internationally.

14-4b Channel Leadership, Cooperation, and Conflict

Each channel member performs a specific role in the distribution system and agrees (implicitly or explicitly) to accept rights, responsibilities, rewards, and sanctions for nonconformity. Moreover, each channel member holds certain expectations of other channel members. Retailers, for instance, expect wholesalers to maintain adequate inventories and deliver goods on time. Wholesalers expect retailers to honor payment agreements and keep them informed of inventory needs. Channel partnerships can facilitate effective supply-chain management when partners agree on objectives, policies, and procedures for physical distribution efforts associated with the supplier's products. Such partnerships eliminate redundancies and reassign tasks for maximum system-wide efficiency.

Channel cooperation reduces wasted resources, such as time, energy, or materials. A coordinated supply chain can also be more environmentally friendly, a consideration that is increasingly important to many organizations and their stakeholders. In fact, research findings show that companies with environmentally-responsible supply chains tend to be more profitable, particularly when a firm's marketing efforts point out the fact that it has a sustainable supply chain.[20] To reduce the carbon footprint of the U.S. auto industry's production processes, equipment manufacturers and suppliers partnered with the Environmental Protection Agency to form the Suppliers Partnership for the Environment. It is a forum for companies and their supply-chain partners to share environmental best practices and optimize supply-chain productivity. The result is a more efficient and less polluting supply chain.[21] In this section, we discuss channel member behavior—including leadership, cooperation, and conflict—that marketers must understand to make effective channel decisions.

Channel Leadership

Many marketing channel decisions are determined through channel member compromise with a better marketing channel as an end goal. Some marketing channels, however, are organized and controlled by a single leader, or **channel captain** (also called *channel leader*). The channel captain may be a producer, wholesaler, or retailer. Channel captains may establish channel policies and coordinate development of the marketing mix. To attain desired objectives, the captain must possess **channel power**, the ability to influence another channel member's goal achievement. The member that becomes the channel captain will accept the responsibilities and exercise the power associated with this role.

When a manufacturer is a channel captain and it determines that it must increase sales volume to achieve production efficiency, it may encourage growth through offering channel members financing, business advice, ordering assistance, advertising services, sales and service training, and support materials. These benefits usually come with requirements related to sales volume, service quality, training, and customer satisfaction.

Retailers may also be channel captains. Walmart, for example, dominates the supply chain for its retail stores by virtue of the magnitude of its resources (especially information management) and a strong, nationwide customer base. To be part of Walmart's supply chain,

channel captain The dominant leader of a marketing channel or a supply channel

channel power The ability of one channel member to influence another member's goal achievement other channel members must agree to Walmart's rules. Small retailers may also assume leadership roles when they gain strong customer loyalty in local or regional markets. Retailers that are channel captains control many brands and sometimes replace uncooperative producers. Increasingly, leading retailers are concentrating their buying power among fewer suppliers, which makes it easier to coordinate and maintain a high level of quality and transparency along the entire supply chain. These more selective relationships often involve long-term commitments, which enable retailers to place smaller and more frequent orders as needed, rather than waiting for large-volume discounts, or placing large orders and assuming the risks associated with carrying more inventory than needed.

Wholesalers can assume channel leadership roles as well. Wholesaler leaders may form voluntary chains with several retailers, which they supply with bulk buying or management services. These retailers may also market the wholesalers' own brands. In return, the retailers shift most of their purchasing to the wholesaler leader. The Independent Grocers' Alliance (IGA) is one of the best-known wholesaler leaders in the United States with nearly 5,000 outlets.[22] IGA's power is based on its expertise in advertising, pricing, and purchasing knowledge that it makes available to independent business owners. Wholesaler channel leaders may help retailers with store layouts, accounting, and inventory control.

Channel Cooperation

Channel cooperation is vital if each member is to gain something from the other members. Cooperation enables retailers, wholesalers, suppliers, and logistics providers to speed up inventory replenishment, improve customer service, and cut the costs of bringing products to the consumer.[23] Because the supply chain is an interrelated system, the success of one firm in the channel depends in part on other member firms. Without cooperation, neither overall channel goals nor individual member goals can be realized. Thus, marketing channel members should make a coordinated effort to satisfy market requirements. Channel cooperation leads to greater trust among channel members and improves the overall functioning of the channel. Cooperation also leads to more satisfying relationships among channel members.

There are several ways to improve channel cooperation. If a marketing channel is viewed as a unified supply chain competing with other systems, individual members will be less likely to take actions that create disadvantages for other members. Channel members should agree to direct efforts toward common objectives. To achieve these objectives efficiently, channel members' roles should be defined precisely. Starting from a common basis allows channel members to set benchmarks for reviewing intermediaries' performance and helps to reduce conflicts as each channel member knows what is expected of it.

Channel Conflict

Although all channel members work toward the same general goal—distributing products profitably and efficiently—members sometimes may disagree about the best methods for attaining this goal. Take a look at the advertisement for TAG Heuer watches. This is a very exclusive brand, which is underscored by featuring the famous actor Leonardo DiCaprio as a model. The brand was previously only available via authorized jewelers. Consumers can now purchase the watches directly from the producer via the company's website, creating possible resentment among brick-and-mortar stores if they lose business. If self-interest creates misunderstanding about role expectations, the end result is frustration and conflict for the whole channel. For individual organizations to function together, each channel member must clearly communicate and understand role expectations. Communication difficulties are a potential form of channel conflict because ineffective communication leads to frustration, misunderstandings, and ill-coordinated strategies, jeopardizing further coordination.

Many firms use multiple channels of distribution, especially now that most retail firms have an online presence. The Internet has increased the potential for conflict and resentment between manufacturers and intermediaries. When a manufacturer makes its products

Tag Heuer

Channel Conflict
Exclusive brands like TAG Heuer, which previously were only available at authorized retailers, risk channel conflict now that they are also sold online via the company's website.

available through the Internet, it is employing a direct channel that competes with the retailers that also sell its products.

Channel conflicts also arise when intermediaries overemphasize competing products or diversify into product lines traditionally handled by other intermediaries. When a producer that has traditionally used franchised dealers broadens its retailer base to include other types of retail outlets, for example, conflict can arise with the traditional outlets. Sometimes conflict develops because producers strive to increase efficiency by circumventing intermediaries. Although there is no single method for resolving conflict, partnerships can be reestablished if two conditions are met. First, the role of each channel member must be clearly defined and adhered to. To minimize misunderstanding, all members must be able to expect unambiguous performance levels from one another. Second, members of channel partnerships must agree on means of coordinating channels, which requires strong, but not polarizing, leadership. To prevent channel conflict, producers or other channel members may provide competing resellers with different brands, allocate markets among resellers, define policies for direct sales to avoid potential conflict over large accounts, negotiate territorial issues among regional distributors, and provide recognition to certain resellers for their importance in distributing to others.

14-4c Channel Integration

Channel members can either combine and control activities or pass them to another channel member. Channel functions may be transferred between intermediaries and producers, even to customers. As mentioned earlier in the chapter, supply-chain functions cannot be eliminated. Unless buyers themselves perform the functions, they must pay for the labor and resources needed to perform them.

Various channel stages may be combined, either horizontally or vertically, under the management of a channel captain. Such integration may stabilize supply, reduce costs, and increase channel member coordination.

Vertical Channel Integration

Vertical channel integration combines two or more stages of the channel under one management. This may occur when one member of a marketing channel purchases the operations of another member or simply performs the functions of another member, eliminating the need for that intermediary. The steel industry, because of high costs and the need for reliable distribution channel intermediaries, tends to feature highly vertically integrated firms. For instance, ArcelorMittal and U.S. Steel are both vertically integrated, carrying out many stages of the channel under one roof.[24]

Vertical channel integration represents a more progressive approach to distribution, in which channel members become extensions of one another as they are combined under a single management. Vertically integrated channels can be more effective against competition because of increased bargaining power and the ease of sharing information and responsibilities. At one end of a vertically integrated channel, a manufacturer might provide advertising and training assistance. At the other end, the retailer might buy the manufacturer's products in large quantities and actively promote them.

vertical channel integration Combining two or more stages of the marketing channel under one management

Integration has been successfully institutionalized in a marketing channel called the **vertical marketing system (VMS)**, in which a single channel member coordinates or manages all activities to maximize efficiencies, resulting in an effective and low-cost distribution system that does not duplicate services. Vertical integration brings most or all stages of the marketing channel under common control or ownership. It can help speed the rate at which goods move through a marketing channel. VMSs account for a large share of retail sales in consumer goods.

Most vertical marketing systems take one of three forms: corporate, administered, or contractual. A *corporate VMS* combines all stages of the marketing channel, from producers to consumers, under a single owner. For example, the Inditex Group, which owns popular clothing retailer Zara, utilizes a corporate VMS to achieve channel efficiencies and maintain a maximum amount of control over the supply chain. Zara's clothing is trendy, requiring the shortest time possible from product development to offering the clothing in stores. Inventory is characterized by very high turnover and frequent changes. Because it has control over all stages of the supply chain, Inditex can maintain an advantage through speed and keeping prices low.[25]

In an *administered VMS,* channel members are independent, but informal coordination achieves a high level of inter-organizational management. Members of an administered VMS may adopt uniform accounting and ordering procedures and cooperate in promotional activities for the benefit of all partners. Although individual channel members maintain autonomy, as in conventional marketing channels, one channel member (such as a producer or large retailer) dominates the administered VMS so that distribution decisions take the whole system into account.

A *contractual VMS* is the most popular type of vertical marketing system. Channel members are linked by legal agreements spelling out each member's rights and obligations. Franchise organizations, such as McDonald's and KFC, are contractual VMSs. Other contractual VMSs include wholesaler-sponsored groups, such as IGA stores, in which independent retailers band together under the contractual leadership of a wholesaler. Retailer-sponsored cooperatives, which own and operate their own wholesalers, are a third type of contractual VMS.

Horizontal Channel Integration

Combining organizations at the same level of operation under one management constitutes **horizontal channel integration**. An organization may integrate horizontally by merging with other organizations at the same level in the marketing channel. The owner of a dry-cleaning firm, for example, might buy and combine several other existing dry-cleaning establishments.

Although horizontal integration permits efficiencies and economies of scale in purchasing, marketing research, advertising, and specialized personnel, it is not always the most effective method of improving distribution. Problems that come with increased size often follow, resulting in decreased flexibility, difficulties coordinating among members, and the need for additional marketing research and large-scale planning. Unless distribution functions for the various units can be performed more efficiently under unified management than under the previously separate managements, horizontal integration will neither reduce costs nor improve the competitive position of the integrating firm.

14-5 PHYSICAL DISTRIBUTION IN SUPPLY-CHAIN MANAGEMENT

Physical distribution, also known as *logistics,* refers to the activities used to move products from producers to consumers and other end users. Physical distribution systems must meet the needs of both the supply chain and customers. Distribution activities are thus an important part of supply-chain planning and can require a high level of cooperation among partners.

vertical marketing system (VMS) A marketing channel managed by a single channel member to achieve efficient, low-cost distribution aimed at satisfying target market customers

horizontal channel integration Combining organizations at the same level of operation under one management

physical distribution Activities used to move products from producers to consumers and other end users

Within the marketing channel, physical distribution activities may be performed by a producer, wholesaler, or retailer, or they may be outsourced. In the context of distribution, *outsourcing* is the contracting of physical distribution tasks to third parties. Most physical distribution activities can be outsourced to outside firms that have special expertise in areas such as warehousing, transportation, inventory management, and information technology. Outsourcing distribution may allow a firm to leverage the expertise of another firm while focusing on its core competencies and freeing up resources to develop value-added capabilities to better serve customers.[26]

Cooperative relationships with third-party organizations, such as trucking companies, warehouses, and data-service providers, can reduce marketing channel costs and boost service and customer satisfaction for all supply-chain partners. When evaluating companies with potential for outsourcing, marketers must be cautious and choose firms that are proven to be efficient and that can help provide excellent customer service. They also need to recognize the importance of logistics functions, like warehousing and information technology, in reducing physical distribution costs associated with outsourcing.

The Internet and technological advancements have revolutionized logistics, allowing many manufacturers to carry out actions and services entirely online, bypassing shipping and warehousing considerations, and transforming physical distribution by facilitating just-in-time delivery, precise inventory visibility, and instant shipment-tracking capabilities. For example, video game and computer software manufacturers have made moves away from physical goods by offering an online download model for their products.[27] Technological advances create new and different problems for manufacturers, such as how to maintain a high level of customer service when customers never enter a store or meet with a salesperson and how to deal with returns of a product that does not exist in a physical form. Because of technology, many companies can now avoid expensive mistakes, reduce costs, and generate increased revenues. Information technology increases the transparency of the supply chain by allowing all marketing channel members to track the movement of goods through the supply chain.[28]

Planning an efficient physical distribution system is crucial to developing an effective marketing strategy because it can decrease costs and increase customer satisfaction. Speed of delivery, flexibility, and quality of service are often as important to customers as costs. Companies that offer the right goods, in the right place, at the right time, in the right quantity, and with the right support services are able to sell more than competitors that do not. Even when the demand for products is unpredictable, suppliers must be able to respond quickly to inventory needs. In such cases, physical distribution costs may be a minor consideration when compared with service, dependability, and timeliness.

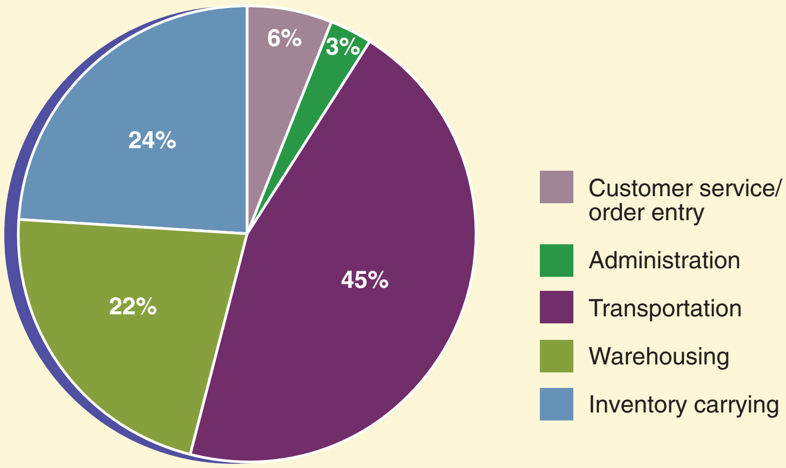
Although physical distribution managers try to minimize the costs associated with order processing, inventory management, materials handling, warehousing, and transportation, decreasing the costs in one area often raises them in another. Figure 14.6 shows the percentage of total costs that physical distribution functions represent. A total-cost approach to physical distribution that takes into account all these different functions enables managers to view physical distribution as a system and shifts the emphasis from lowering the costs of individual activities to minimizing overall costs.

Physical distribution managers must be sensitive to the issue of cost trade-offs. Trade-offs are strategic decisions to combine (and recombine) resources for greatest cost-effectiveness. The goal is not always to find the lowest cost, but rather to find the right balance of costs. Higher costs in one functional area of a distribution system may be necessary to achieve lower costs in another. When distribution managers regard the system as a network of integrated functions, trade-offs become useful tools in implementing a unified, cost-effective distribution strategy.

Another important goal of physical distribution involves **cycle time**, the time needed to complete a process. For instance, reducing cycle time while maintaining or reducing costs and/or maintaining or increasing customer service is a winning combination in supply chains and ultimately leads to greater end-customer satisfaction. Firms should aim to find ways to reduce cycle time while maintaining or reducing costs and maintaining or improving customer service.

cycle time The time needed to complete a process

Figure 14.6 **Proportional Cost of Each Physical Distribution Function as a Percentage of Total Distribution Costs**



In the process of growing from a tiny business with a highly popular viral video to a large business that ships razor blades to men across the country on a subscription basis, Dollar Shave Club had to find a way to reduce cycle time while maintaining high customer satisfaction and quality. It enlisted the help of a third-party logistics specialist, which allowed it to focus on providing excellent customer service while ensuring on-time deliveries to subscribers.[29] In the rest of this section, we take a closer look at a variety of physical distribution activities, including order processing, inventory management, materials handling, warehousing, and transportation.

14-5a Order Processing

Order processing is the receipt and transmission of sales order information. Although management sometimes overlooks the importance of these activities, efficient order processing facilitates product flow. Computerized order processing provides a platform for information management, allowing all supply-chain members to increase their productivity. When carried out quickly and accurately, order processing contributes to customer satisfaction, decreased costs and cycle time, and increased profits.

Order processing entails three main tasks: order entry, order handling, and order delivery. Order entry begins when customers or salespeople place purchase orders via telephone, regular mail, e-mail, or website. Electronic ordering has become the most common. It is less time-consuming than a paper-based ordering system and reduces costs. In some companies, sales representatives receive and enter orders personally and also handle complaints, prepare progress reports, and forward sales order information.

Order handling involves several tasks. Once an order is entered, it is transmitted to a warehouse to verify product availability and to the credit department to set terms and prices and to check the customer's credit rating. If the credit department approves the purchase, warehouse personnel assemble the order. In many warehouses, automated machines carry out this step. If the requested product is not in stock, a production order is sent to the factory, or the customer is offered a substitute.

When the order has been assembled and packed for shipment, the warehouse schedules delivery with an appropriate carrier. If the customer pays for rush service, overnight delivery by an overnight carrier is used. The customer is sent an invoice, inventory records are adjusted, and the order is delivered.

order processing The receipt and transmission of sales order information

Whether a company uses a manual or an electronic order-processing system depends on which method provides greater speed and accuracy within cost limits. Manual processing suffices for small-volume orders and can be more flexible in certain situations. Most companies, however, use **electronic data interchange (EDI)**, which uses computer technology to integrate order processing with production, inventory, accounting, and transportation. Within the supply chain, EDI functions as an information system that links marketing channel members and outsourcing firms together. It reduces paperwork for all members of the supply chain and allows them to share information on invoices, orders, payments, inquiries, and scheduling. Many companies encourage suppliers to adopt EDI to reduce distribution costs and cycle times.

14-5b Inventory Management

Inventory management involves developing and maintaining adequate assortments of products to meet customers' needs. It is a key component of any effective physical distribution system. Inventory decisions have a major impact on physical distribution costs and the level of customer service provided. When too few products are carried in inventory, the result is *stockouts,* or shortages of products. Stockouts can result in customer dissatisfaction that leads to lower sales, even loss of customers and brand switching. On the other hand, when a firm maintains too many products (especially too many low-turnover products) in inventory, costs increase, as do risks of product obsolescence, pilferage, and damage. The objective of inventory management is to minimize inventory costs while maintaining an adequate supply of goods to satisfy customers. To achieve this objective, marketers focus on two major issues: when to order and how much to order.

To determine when to order, a marketer calculates the *reorder point*: the inventory level that signals the need to place a new order. To calculate the reorder point, the marketer must know the order lead time, the usage rate, and the amount of safety stock required. The *order lead time* refers to the average time lapse between placing the order and receiving it. The *usage rate* is the rate at which a product's inventory is used or sold during a specific time period. *Safety stock* is the amount of extra inventory a firm keeps to guard against stockouts resulting from above-average usage rates and/or longer-than-expected lead times. The reorder point can be calculated using the following formula:

$$\text{Reorder Point} = (\text{Order Lead Time} \times \text{Usage Rate}) + \text{Safety Stock}$$

Thus, if order lead time is 10 days, usage rate is 3 units per day, and safety stock is 20 units, the reorder point is 50 units.

Efficient inventory management with accurate reorder points is crucial for firms that use a **just-in-time (JIT)** approach, in which supplies arrive just as they are needed for use in production or for resale. Companies that use JIT (sometimes referred to as *lean distribution*) can maintain low inventory levels and purchase products and materials in small quantities only when needed. Usually there is no safety stock in a JIT system. Suppliers are expected to provide consistently high-quality products exactly when they are needed. JIT inventory management requires a high level of coordination between producers and suppliers, but it eliminates waste and reduces inventory costs. Toyota was a pioneer of JIT distribution. More recently, Harley Davidson applied JIT distribution methods to reduce costs, increase production flexibility, and improve supply-chain management. The alterations to its supply-chain management system helped Harley successfully turn the business around from near failure.[30] When a JIT approach is used in a supply chain, suppliers may move operations close to their major customers in order to provide goods as quickly as possible.

electronic data interchange (EDI) A computerized means of integrating order processing with production, inventory, accounting, and transportation

inventory management Developing and maintaining adequate assortments of products to meet customers' needs

just-in-time (JIT) An inventory-management approach in which supplies arrive just when needed for production or resale

materials handling Physical handling of tangible goods, supplies, and resources

14-5c Materials Handling

Materials handling, the physical handling of tangible goods, supplies, and resources, is an important factor in warehouse operations, as well as in transportation from points of production to points of consumption. Efficient procedures and techniques for materials handling minimize inventory management costs, reduce the number of times a good is handled, improve customer service, and increase customer satisfaction. Systems for packaging, labeling, loading, and movement must be coordinated to maximize cost reduction and customer satisfaction.

Many firms use radio waves to track materials tagged with radio frequency identification (RFID) through every phase of handling. RFID has greatly improved shipment tracking and reduced cycle times. Hundreds of RFID tags can be read at a time, which represents an advantage over barcodes. Firms are discovering that RFID technology has very broad applications, from tracking inventory to paying for goods and services, asset management, and data collection. For instance, Disney theme parks use RFID in visitor wristbands, called MagicBands. The bands encode visitor wristbands with credit card information, allowing visitors to make purchases with the swipe of a wrist. RFID technology tracks movements within the park to alert them when it is their turn for a nearby ride. Although some are concerned about how much information Disney will be able to collect using the data from wristbands, many of Disney Parks' 30 million annual visitors enjoy the chance not to worry about money and not having to stand in line—which improves the customer experience.[31] Product characteristics often determine handling. For example, the characteristics of bulk liquids and gases determine how they can be moved and stored. Internal packaging is also an important consideration in materials handling. Goods must be packaged correctly to prevent damage or breakage during handling and transportation. Many companies employ packaging consultants during the product design process to help them decide which packaging materials and methods will result in the most efficient handling. Consider the advertisement for Americold, which is a warehousing and logistics company that specializes in the distribution of perishable goods. Firms that produce food items or other goods that must remain cold may want to consider working with such an organization because they feature temperature-controlled warehouses and shipping. Such an operation can help a firm with inventory management by maximizing the shelf life of goods and minimizing loss.

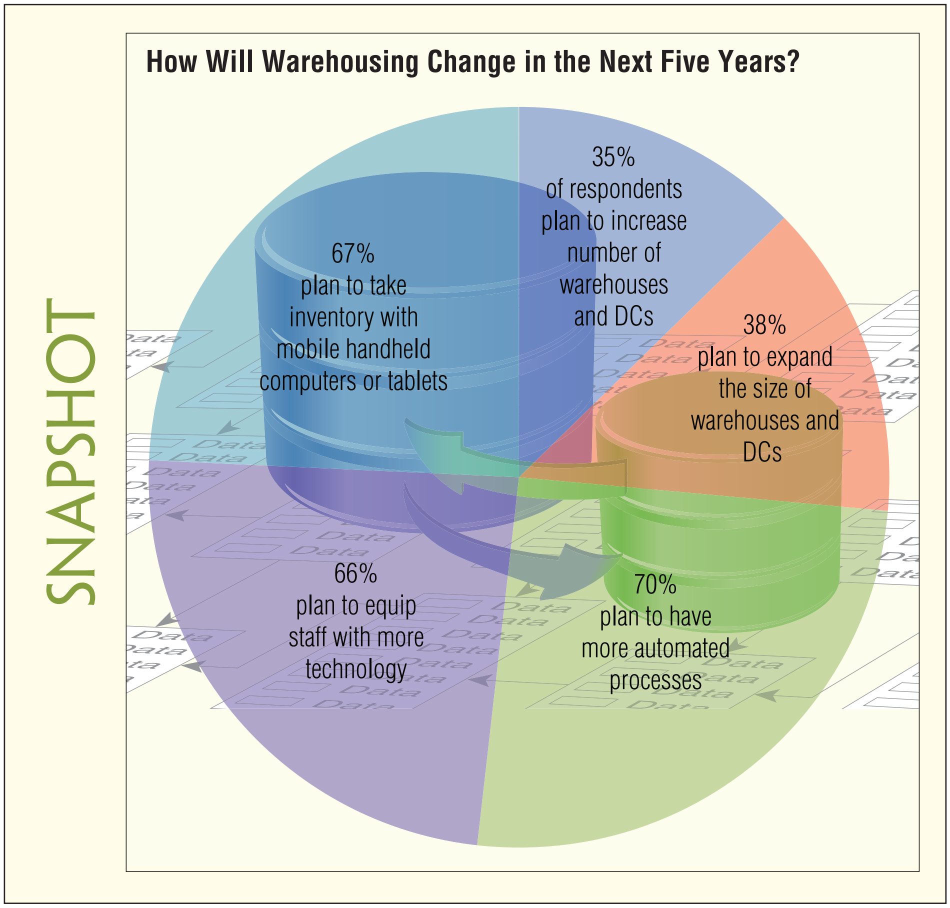
Warehousing and Inventory Management
Americold helps firms that must transport perishable items, such as food, by offering temperature-controlled warehousing and shipping.

Unit loading and containerization are two common methods used in materials handling. With *unit loading,* one or more boxes are placed on a pallet or skid. These units can then be loaded efficiently by mechanical means, such as forklifts, trucks, or conveyer systems. *Containerization* is the consolidation of many items into a single, large container that is sealed at its point of origin and opened at its destination. Containers are usually 8 feet wide, 8 feet high, and 10 to 40 feet long. Their uniform size means they can be stacked and shipped via train, barge, or ship. Once containers reach their destinations, wheel assemblies can be added to make them suitable for ground transportation by truck. Because individual items are not handled in transit, containerization greatly increases efficiency and security in shipping.

14-5d Warehousing

Warehousing, the design and operation of facilities for storing and moving goods, is another important physical distribution function. Warehousing provides time utility by enabling firms to compensate for dissimilar production and consumption rates. When mass production

warehousing The design and operation of facilities for storing and moving goods



Source: 2013 Warehouse Vision Report, Motorola Solutions.

creates a greater stock of goods than can be sold immediately, companies warehouse the surplus until customers are ready to buy it. Warehousing also helps to stabilize prices and the availability of seasonal items.

Choosing appropriate warehouse facilities is an important strategic consideration because they allow a company to reduce transportation and inventory costs and improve service to customers. The wrong type of warehouse can lead to inefficient physical distribution and added costs. Warehouses fall into two general categories: private and public. In many cases, a combination of private and public facilities provides the most flexible warehousing approach.

Companies operate **private warehouses** for shipping and storing their own products. A firm usually leases or purchases a private warehouse when its warehousing needs in a given geographic market are substantial and stable enough to warrant a long-term commitment to a fixed facility. Private warehouses are also appropriate for firms that require special handling and storage and that want control of warehouse design and operation. Retailers like Sears find it economical to integrate private warehousing with purchasing and distribution for their retail outlets. When sales volumes are fairly stable, ownership and control of a private warehouse may be most convenient and offer cost benefits. Private warehouses, however, face fixed costs, such as insurance, taxes, maintenance, and debt expense. They limit firms' flexibility if they wish to move inventories to different locations. Many private warehouses are being eliminated by direct links between producers and customers, reduced cycle times, and outsourcing to public warehouses.

Public warehouses lease storage space and related physical distribution facilities to other companies. They sometimes provide distribution services, such as receiving, unloading, inspecting, filling orders, financing, displaying products, and coordinating shipments. Distribution Unlimited Inc., for example, offers a wide range of such services through its facilities in New York, which contain more than 8 million square feet of warehouse space.[32]

Public warehouses are especially useful to firms that have seasonal production or demand, low-volume storage needs, and inventories that must be maintained in many locations. They are also useful for firms that are testing or entering new markets or require additional storage space. Additionally, public warehouses serve as collection points during product-recall programs. Whereas private warehouses have fixed costs, public warehouses offer variable (and possibly lower) costs because users rent space and purchase warehousing services only as needed.

Many public warehouses furnish security for products that are used as collateral for loans, a service provided at either the warehouse or the site of the owner's inventory. *Field public warehouses* are established by public warehouses at the owner's inventory location.

private warehouses Company-operated facilities for storing and shipping products

Public warehouses Storage space and related physical distribution facilities that can be leased by companies

The warehouser becomes custodian of the products and issues a receipt that can be used as collateral for a loan. Public warehouses also provide *bonded storage*, a warehousing arrangement in which imported or taxable products are not released until the products' owners pay U.S. customs duties, taxes, or other fees. Bonded warehouses enable firms to defer tax payments on such items until they are delivered to customers.

Distribution centers are large facilities used for receiving, warehousing, and redistributing products to stores or customers. They are specially designed for rapid flow of products and are usually one-story buildings with access to transportation networks, such as major highways and/or railway lines. Many distribution centers are automated, with computer-directed robots, forklifts, and hoists that collect and move products to loading docks. Distribution over large geographic areas can be complicated but having strategically located distribution centers can help a company meet consumer demand. Even Walmart had to build more distribution centers to accommodate a greater number of online sales as it positioned itself to compete directly with Amazon.[33] Although some public warehouses offer such specialized services, most distribution centers are privately owned. They serve customers in regional markets and, in some cases, function as consolidation points for a company's branch warehouses.

14-5e Transportation

Transportation, the movement of products from where they are made to intermediaries and end users, is the most expensive physical distribution function. Freight costs can vary widely among countries, or even regions within the same country, depending on the level of infrastructure and the prevalence of different modes of transportation in an area.[34] Because product availability and timely deliveries depend on transportation functions, transportation decisions directly affect customer service. In some cases, a firm may choose to build its distribution and marketing strategy around a unique transportation system if that system can ensure on-time deliveries and give the firm a competitive edge. Companies may build their own transportation fleets (private carriers) or outsource the transportation function to a common or contract carrier.

distribution centers Large, centralized warehouses that focus on moving rather than storing goods

transportation The movement of products from where they are made to intermediaries and end users

Transportation Modes

The basic transportation modes for moving physical goods are railroads, trucks, waterways, airways, and pipelines. Each has distinct advantages. Many companies adopt physical handling procedures that facilitate the use of two or more modes in combination. Table 14.3 gives more detail on the characteristics of each transportation mode.

Table 14.3 Characteristics and Ratings of Transportation Modes by Selection Criteria

Selection Criteria	Railroads	Trucks	Pipelines	Waterways	Airplanes
Cost	Moderate	High	Low	Very low	Very high
Speed	Average	Fast	Slow	Very slow	Very fast
Dependability	Average	High	High	Average	High
Load flexibility	High	Average	Very low	Very high	Low
Accessibility	High	Very high	Very limited	Limited	Average
Frequency	Low	High	Very high	Very low	Average
Products carried	Coal, grain, lumber, paper and pulp products, chemicals	Clothing, computers, books, groceries and produce, livestock	Oil, processed coal, natural gas	Chemicals, bauxite, grain, motor vehicles, agricultural implements	Flowers, food (highly perishable), technical instruments, emergency parts and equipment, overnight mail

Railroads like Union Pacific and Canadian National carry heavy, bulky freight that must be shipped long distances over land. Railroads commonly haul minerals, sand, lumber, chemicals, and farm products, as well as low-value manufactured goods and automobiles. Railroads are especially efficient for transporting full carloads, which can be shipped at lower rates than smaller quantities, because they require less handling. Many companies locate factories or warehouses near rail lines for convenient loading and unloading.

Trucks provide the most flexible schedules and routes of all major transportation modes in the United States because they can go almost anywhere. Because trucks do not have to conform to a set schedule and can move goods from factory or warehouse to customer, wherever there are roads, they are often used in conjunction with other forms of transport that cannot provide door-to-door deliveries, such as waterways and railroads. Trucks are more expensive and somewhat more vulnerable to bad weather than trains. They are also subject to size and weight restrictions on the loads they carry. Trucks are sometimes criticized for high levels of loss and damage to freight and for delays caused by the re-handling of small shipments.

Waterways are the cheapest method of shipping heavy, low-value, nonperishable goods. Water carriers offer considerable capacity. Powered by tugboats and towboats, barges that travel along intra-coastal canals, inland rivers, and navigation systems can haul at least 10 times the weight of one rail car, and oceangoing vessels can haul thousands of containers. The vast majority of international cargo is transported by water at least part of the way. However, many markets are inaccessible by water transportation and must be supplemented by rail or truck. Droughts and floods also may create difficulties for users of inland waterway transportation. Nevertheless, the growing need to transport goods long distances across the globe will likely increase its use in the future.

Air transportation is the fastest but most expensive form of shipping. It is used most often for perishable goods, for high-value and/or low-bulk items, and for products that require quick delivery over long distances. Some air carriers transport combinations of passengers, freight, and mail. Despite its expense, air transit can reduce warehousing and packaging costs and losses from theft and damage, thus helping the aggregate cost of the mode. Although air transport accounts for a small minority of total cargo carried, it is an important form of transportation in an increasingly time-sensitive business environment.[35] In fact, the success of many businesses is now based on the availability of overnight air delivery service provided by such organizations as

Emerging Trends

Click to Buy and Get Same-Day Delivery

Same-day delivery has become a competitive battleground as online retailers and traditional stores appeal to time-pressured consumers who do not want to wait even one day to receive purchases made online or by smartphone. Walmart has been testing same-day delivery of groceries since 2011, expanding from California to Denver and beyond. Shoppers can click to buy tens of thousands of items and select a 2-hour window for delivery. Branded Walmart To Go trucks bring purchases right to the customer's front door, for a small delivery fee.

This helps Walmart compete more effectively with nonstore retailers like Amazon, which offers same-day delivery of groceries through its AmazonFresh program. Amazon started the delivery service in Seattle and then expanded to California as it prepared warehouses and branded trucks to service customers. The online auction company eBay recently bought a delivery company, Shutl, so it can speed deliveries to customers in major metropolitan areas. Shutl has a high-tech system of routing pickups to different carriers based on location, availability, and other factors.

Even Google is getting into the delivery business with Shopping Express, tested with its own employees and now available in many parts of California. Shopping Express invites customers to click and buy from more than a dozen retailers, including Staples, Whole Foods, and Walgreens, and then select a 3- to 5-hour slot for delivery. Now the companies are waiting to see whether customers will find same-day delivery as convenient and valuable as the instant gratification of buying something in a store and having it right away.[b]

UPS, FedEx, DHL, RPS Air, and the U.S. Postal Service. Many firms offer overnight or same-day shipping to customers.

Pipelines, the most automated transportation mode, usually belong to the shipper and carry the shipper's products. Most pipelines carry petroleum products or chemicals. Slurry pipelines carry pulverized coal, grain, or wood chips suspended in water. Pipelines move products slowly but continuously and at relatively low cost. They are dependable and minimize the problems of product damage and theft. However, contents are subject to as much as 1 percent shrinkage, usually from evaporation—which can result in profit losses. Pipelines also have been a concern to environmentalists, who fear installation and leaks could harm plants and animals.

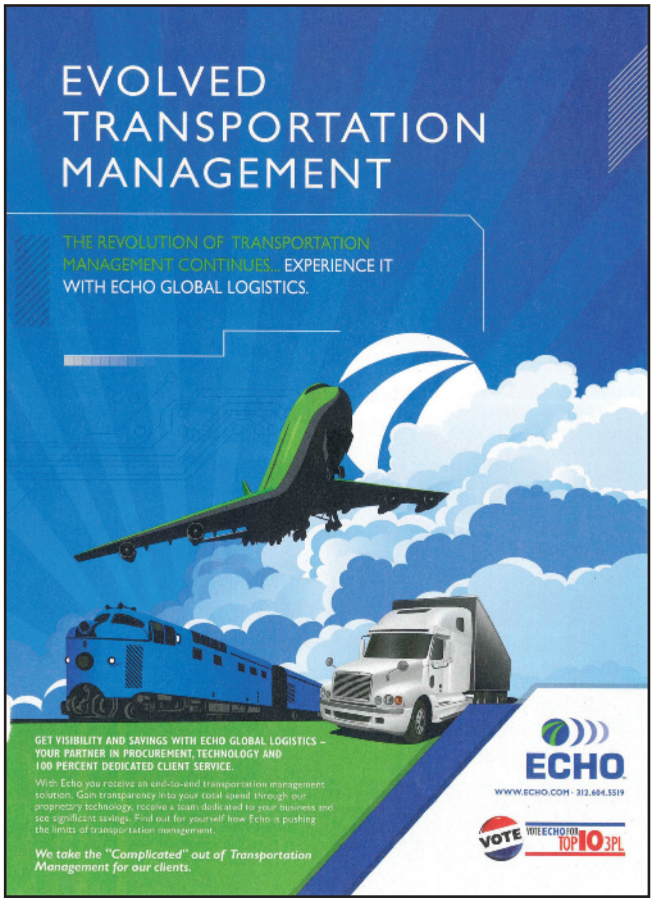
Choosing Transportation Modes

Logistics managers select a transportation mode based on the combination of cost, speed, dependability, load flexibility, accessibility, and frequency that is most appropriate for their products and generates the desired level of customer service. Table 14.3 shows relative ratings of each transportation mode by these selection criteria.

Marketers compare alternative transportation modes to determine whether the benefits from a more expensive mode are worth the higher costs. A firm wishing to establish international distribution may consider a large logistics firm for its vast network of global partners. Exel Logistics, for instance, offers 500 sites and 40,000 associates in the Americas alone and provides the staffing and expertise to perform many supply-chain management functions at locations around the globe.[36] Look at the Echo advertisement—it is an international logistics company that helps firms to determine which modes of transportation are most important for distributing their products. You can see from the advertisement that Echo will help a firm develop a seamless distribution channel using all available options, including air, rail, and trucks.

intermodal transportation Two or more transportation modes used in combination

freight forwarders Organizations that consolidate shipments from several firms into efficient lot sizes



Echo Global Logistics

Transportation Modes
A logistics company such as Echo can help firms to develop an efficient distribution network using multiple transportation modes.

Coordinating Transportation

To take advantage of the benefits offered by various transportation modes and compensate for shortcomings, marketers often combine and coordinate two or more modes. **Intermodal transportation** is easier than ever because of developments within the transportation industry. It combines the flexibility of trucking with the low cost or speed of other forms of transport. Containerization facilitates intermodal transportation by consolidating shipments into sealed containers for transport by *piggyback* (using truck trailers and railway flatcars), *fishyback* (using truck trailers and water carriers), and *birdyback* (using truck trailers and air carriers). As transportation costs have increased and firms seek to find the most efficient methods possible, intermodal shipping has gained popularity.

Specialized outsourcing agencies provide other forms of transport coordination. Known as **freight forwarders**, these firms combine shipments from several organizations into efficient lot sizes. Small loads (less than 500 pounds) are much more expensive to ship than full carloads or truckloads and may make shipping cost-prohibitive for smaller firms. Freight forwarders help such firms by consolidating small loads from various organizations to allow them to qualify collectively for lower rates. Freight forwarders' profits come from the margin between the higher rates firms would have to pay and the lower carload rates the freight forwarder pays

Intermodal Transportation Containers facilitate intermodal transportation because they can be transported by ships, trains, and trucks.

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for full loads. Because large shipments also require less handling, freight forwarders can reduce delivery time and the likelihood of shipment damage. Freight forwarders also have the insight to determine the most efficient carriers and routes and are useful for shipping goods to foreign markets, including in foreign markets. Shipping firms such as UPS and FedEx offer freight-forwarding services, as do dedicated freight forwarders such as NRA Global Logistics or Worldwide Express. Some companies may prefer to outsource their shipping to freight forwarders because the forwarders provide door-to-door service.

Another transportation innovation is the development of **megacarriers**, freight transportation companies that offer several shipment methods, including rail, truck, and air service. Prior to the development of megacarriers, transportation companies generally only specialized in one mode. To compete with megacarriers, air carriers have increased their ground-transportation services. As the range of transportation alternatives expands, carriers also put greater emphasis on customer service to gain a competitive advantage.

14-6 LEGAL ISSUES IN CHANNEL MANAGEMENT

The numerous federal, state, and local laws governing distribution channel management in the United States are based on the principle that the public is best served by protecting competition and free trade. Under the authority of federal legislation, such as the Sherman Antitrust Act and the Federal Trade Commission Act, courts and regulatory agencies determine under what circumstances channel management practices violate this underlying principle and must be restricted. Although channel managers are not expected to be legal experts, they should be aware that attempts to control distribution functions might have legal repercussions. When shipping internationally, managers must also be aware of international laws and regulations that might affect their distribution activities. The following practices are among those frequently subject to legal restraint.

14-6a Dual Distribution

megacarriers Freight transportation firms that provide several modes of shipment

Earlier, we noted that some companies employ dual distribution by using two or more marketing channels to distribute the same products to the same target market. Courts do not consider this practice illegal when it allows for competition. A manufacturer can also legally open its own retail outlets. However, the courts view a manufacturer that uses company-owned outlets to dominate or drive out of business independent retailers or distributors that handle its products as a threat to competition. In such cases, dual distribution violates the law. To avoid this interpretation, producers should use outlet prices that do not severely undercut independent retailers' prices.

14-6b Restricted Sales Territories

To tighten control over product distribution, a manufacturer may try to prohibit intermediaries from selling outside of designated sales territories. Intermediaries often favor this practice because it provides them with exclusive territories where they can minimize competition. Over the years, the courts have adopted conflicting positions in regard to restricted sales territories. Although the courts have deemed restricted sales territories a restraint of trade among intermediaries handling the same brands (except for small or newly established companies), they have also held that exclusive territories can actually promote competition among dealers handling different brands. At present, the producer's intent in establishing restricted territories and the overall effect of doing so on the market must be evaluated for each individual case.

14-6c Tying Agreements

When a supplier (usually a manufacturer or franchisor) furnishes a product to a channel member with the stipulation that the channel member must purchase other products as well, it has negotiated a **tying agreement**. Suppliers may institute tying agreements as a means of getting rid of slow-moving inventory, or a franchisor may tie the purchase of equipment and supplies to the sale of franchises, justifying the policy as necessary for quality control and protection of the franchisor's reputation.

A related practice is *full-line forcing*, in which a supplier requires that channel members purchase the supplier's entire line to obtain any of the supplier's products. Manufacturers sometimes use full-line forcing to ensure that intermediaries accept new products and that a suitable range of products is available to customers.

The courts accept tying agreements when the supplier is the only firm able to provide products of a certain quality, when the intermediary is free to carry competing products as well, and when a company has just entered the market. Most other tying agreements are considered illegal.

14-6d Exclusive Dealing

When a manufacturer forbids an intermediary to carry products of competing manufacturers, the arrangement is called **exclusive dealing**. Manufacturers receive considerable market protection in an exclusive-dealing arrangement and may cut off shipments to intermediaries that violate the agreement.

The legality of an exclusive-dealing contract is determined by applying three tests. If the exclusive dealing blocks competitors from as much as 15 percent of the market, the sales volume is large, and the producer is considerably larger than the retailer, then the arrangement is considered anticompetitive. If dealers and customers in a given market have access to similar products or if the exclusive-dealing contract strengthens an otherwise weak competitor, the arrangement is allowed.

14-6e Refusal to Deal

For nearly a century, courts have held that producers have the right to choose or reject the channel members with which they will do business. Within existing distribution channels, however, suppliers may not legally refuse to deal with wholesalers or dealers merely because these wholesalers or dealers resist policies that are anticompetitive or in restraint of trade. Suppliers are further prohibited from organizing some channel members in refusal-to-deal actions against other members that choose not to comply with illegal policies.

tying agreement An agreement in which a supplier furnishes a product to a channel member with the stipulation that the channel member must purchase other products as well

exclusive dealing A situation in which a manufacturer forbids an intermediary from carrying products of competing manufacturers

Summary

14-1 Describe the foundations of supply-chain management.

The distribution component of the marketing mix focuses on the decisions and activities involved in making products available to customers when and where they want to purchase them. An important function of distribution is the joint effort of all involved organizations to be part of creating an effective supply chain, which refers to all the activities associated with the flow and transformation of products from raw materials through to the end customer. Operations management is the total set of managerial activities used by an organization to transform resource inputs into goods, services, or both. Logistics management involves planning, implementation, and controlling the efficient and effective flow and storage of goods, services, and information from the point of origin to consumption to meet customers' needs and wants. Supply management in its broadest form refers to the processes that enable the progress of value from raw material to final customer and back to redesign and final disposition. Supply-chain management therefore refers to a set of approaches used to integrate the functions of operations management, logistics management, supply management, and marketing channel management so that goods and services are produced and distributed in the right quantities, to the right locations, and at the right time. The supply chain includes all entities—shippers and other firms that facilitate distribution, as well as producers, wholesalers, and retailers—that distribute products and benefit from cooperative efforts.

14-2 Explain the role and significance of marketing channels and supply chains.

A marketing channel, or channel of distribution, is a group of individuals and organizations that direct the flow of products from producers to customers. The major role of marketing channels is to make products available at the right time, at the right place, and in the right amounts. In most channels of distribution, producers and consumers are linked by marketing intermediaries. The two major types of intermediaries are retailers, which purchase products and resell them to ultimate consumers, and wholesalers, which buy and resell products to other wholesalers, retailers, and business customers.

Marketing channels serve many functions. They create time, place, and possession utilities by making products available when and where customers want them and providing customers with access to product use through sale or rental. Marketing intermediaries facilitate exchange efficiencies, often reducing the costs of exchanges by performing certain services and functions. Although some critics suggest eliminating wholesalers, the functions of the intermediaries in the marketing channel must be performed. As such, eliminating one or more intermediaries results in other organizations in the channel having to do more. Because intermediaries serve both producers and buyers, they reduce the total number of transactions that otherwise would be needed to move products from producer to the end customer.

Channels of distribution are broadly classified as channels for consumer products and channels for business products. Within these two broad categories, different channels are used for different products. Although consumer goods can move directly from producer to consumers, consumer channels that include wholesalers and retailers are usually more economical and knowledge-efficient. Distribution of business products differs from that of consumer products in the types of channels used. A direct distribution channel is common in business marketing. Also used are channels containing industrial distributors, manufacturers' agents, and a combination of agents and distributors. Most producers have multiple or dual channels so the distribution system can be adjusted for various target markets.

Selecting an appropriate marketing channel is a crucial decision for supply-chain managers. To determine which channel is most appropriate, managers must think about customer characteristics, the type of organization, product attributes, competition, environmental forces, and the availability and characteristics of intermediaries. Careful consideration of these factors will assist a supply-chain manager in selecting the correct channel.

14-3 Identify the intensity of market coverage.

A marketing channel is managed such that products receive appropriate market coverage. In choosing intensive distribution, producers strive to make a product available to all possible dealers. In selective distribution, only some outlets in an area are chosen to distribute a product. Exclusive distribution usually gives a single dealer rights to sell a product in a large geographic area.

14-4 Describe strategic issues in marketing channels, including leadership, cooperation, and conflict.

Each channel member performs a different role in the system and agrees to accept certain rights, responsibilities, rewards, and sanctions for nonconformance. Although many marketing channels are determined by consensus, some are organized and controlled by a single leader, or channel captain. A channel captain may be a producer, wholesaler, or retailer. A marketing channel functions most effectively when members cooperate. When they deviate from their roles, channel conflict can arise.

Integration of marketing channels brings various activities under one channel member's management. Vertical integration combines two or more stages of the channel under one management. The vertical marketing system (VMS) is managed centrally for the mutual benefit of all channel members. Vertical marketing systems may be corporate, administered, or contractual. Horizontal integration combines institutions at the same level of channel operation under a single management.

14-5 Explain physical distribution as being a part of supply-chain management.

Physical distribution, or logistics, refers to the activities used to move products from producers to customers and other end users. These activities include order processing, inventory management, materials handling, warehousing, and transportation. An efficient physical distribution system is an important component of an overall marketing strategy because it can decrease costs and increase customer satisfaction. Within the marketing channel, physical distribution activities are often performed by a wholesaler, but they may also be performed by a producer or retailer or outsourced to a third party. Efficient physical distribution systems can decrease costs and transit time while increasing customer service.

Order processing is the receipt and transmission of sales order information. It consists of three main tasks—order entry, order handling, and order delivery—that may be done manually but are more often handled through electronic data interchange systems. Inventory management involves developing and maintaining adequate assortments of products to meet customers' needs. Logistics managers must strive to find the optimal level of inventory to satisfy customer needs while keeping costs down. Materials handling, the physical handling of products, is a crucial element in warehousing and transporting products. Warehousing involves the design and operation of facilities for storing and moving goods. Such facilities may be privately owned or public. Transportation, the movement of products from where they are made to where they are purchased and used, is the most expensive physical distribution function. The basic modes of transporting goods include railroads, trucks, waterways, airways, and pipelines.

14-6 Describe legal issues in channel management.

Federal, state, and local laws regulate channel management to protect competition and free trade. Courts may prohibit or permit a practice depending on whether it violates this underlying principle. Channel management practices frequently subject to legal restraint include dual distribution, restricted sales territories, tying agreements, exclusive dealing, and refusal to deal. When these practices strengthen weak competitors or increase competition among dealers, they may be permitted. In most other cases, when competition may be weakened considerably, they are deemed illegal.

Go to www.cengagebrain.com for resources to help you master the content in this chapter as well as materials that will expand your marketing knowledge!

Developing Your Marketing Plan

One of the key components in a successful marketing strategy is the plan for getting the products to your customer. To make the best decisions about where, when, and how your products will be made available to the customer, you need to know more about how these distribution decisions relate to other marketing-mix elements in your marketing plan. To assist you in relating the information in this chapter to your marketing plan, consider the following issues:

1. Marketing intermediaries perform many activities. Using Table 14.2 as a guide, discuss the types of activities where a channel member could provide needed assistance.
2. Using Figure 14.2 (or Figure 14.3 if your product is a business product), determine which of the channel distribution paths is most appropriate for your product. Given the nature of your product, could it be distributed through more than one of these paths?
3. Determine the level of distribution intensity that is appropriate for your product. Consider the characteristics of your target market(s), the product attributes, and environmental factors in your deliberation.
4. Discuss the physical functions that will be required for distributing your product, focusing on materials handling, warehousing, and transportation.

The information obtained from these questions should assist you in developing various aspects of your marketing plan found in the "Interactive Marketing Plan" exercise at **www.cengagebrain.com**.

Important Terms

distribution 410
supply chain 410
operations management 410
logistics management 410
supply management 410
supply-chain management 410
marketing channel 412
marketing intermediaries 412
industrial distributor 417

Discussion and Review Questions

1. Define supply-chain management. Why is it important?
2. Describe the major functions of marketing channels. Why are these functions better accomplished through combined efforts of channel members?
3. List several reasons consumers often blame intermediaries for distribution inefficiencies.
4. Compare and contrast the four major types of marketing channels for consumer products. Through which type of channel is each of the following products most likely to be distributed?
   a. New automobiles
   b. Saltine crackers
   c. Cut-your-own Christmas trees
   d. New textbooks
   e. Sofas
   f. Soft drinks
5. Outline the four most common channels for business products. Describe the products or situations that lead marketers to choose each channel.
6. Describe an industrial distributor. What types of products are marketed through an industrial distributor?
7. Under what conditions is a producer most likely to use more than one marketing channel?
8. Identify and describe the factors that may influence marketing channel selection decisions.
9. Explain the differences among intensive, selective, and exclusive methods of distribution.
10. Comment on this statement. "Channel cooperation requires that members support the overall channel goals to achieve individual goals."
11. Explain the major characteristics of each of the three types of vertical marketing systems (VMSs): corporate, administered, and contractual.
12. Discuss the cost and service trade-offs involved in developing a physical distribution system.
13. What are the main tasks involved in order processing?
14. Explain the trade-offs that inventory managers face when they reorder products or supplies. How is the reorder point computed?
15. Explain the major differences between private and public warehouses. How do they differ from a distribution center?
16. Compare and contrast the five major transportation modes in terms of cost, speed, and dependability.
17. Under what conditions are tying agreements, exclusive dealing, and dual distribution judged illegal?

Video Case 14.1

Taza Cultivates Channel Relationships with Chocolate

Taza Chocolate is a small Massachusetts-based manufacturer of stone-ground organic chocolate made in the classic Mexican tradition. Founded in 2006, Taza markets most of its products through U.S. retailers, wholesalers, and distributors. Individual customers around the world can also buy Taza chocolate bars, baking squares, chocolate-covered nuts, and other specialty items directly from the Taza website. If they live in Somerville, Massachusetts, they might even find a Taza employee riding a "chococycle," selling products and distributing samples at an upscale food-truck festival or a weekend market festival.

Taza seeks to make personal connections with all the certified organic growers who supply its ingredients. "Because our process here at the factory is so minimal," says the company's director of sales, "it's really important that we get a very high-quality ingredient. To make sure that we're getting the absolute cream of the [cocoa] crop, we have a direct face-to-face human relationship between us and the actual farmer who's producing those beans."

Dealing directly with suppliers allows Taza to meet its social responsibility goals while ensuring the kind of quality that commands a premium price. "We're a premium brand," explains the director of sales, "and because of the way we do what we do, we have to charge more than your average chocolate bar." A Taza chocolate bar that sells at a retail price of $4.50 carries a wholesale price of about $2.70. The distributor's price, however, is even lower, closer to $2.00.

Distributors buy in the largest quantities, which for Taza means a pallet load rather than a case that a wholesaler would buy. "But wholesale will always be our bread and butter, where we really move the volume and we have good margins," says Taza's director of sales. In the company's experience, distributors are very price-conscious and more interested than wholesalers in promotions and extras.

Taza offers factory tours at its Somerville site, charging a small entrance fee that includes a donation to Sustainable Harvest International. There, visitors can watch the bean-to-bar process from beginning to end, learning about the beans and the stone-ground tradition that differentiates Taza from European chocolates. Visitors enjoy product samples along the way and, at the end of the tour, they can browse through the factory store and buy freshly-made specialties like chipotle chili chocolate and ginger chocolate. On holidays like Halloween and Valentine's Day, Taza hosts special tastings and limited-edition treats to attract customers to its factory store. Its annual beer-and-chocolate pairing event, hosted with the Drink Craft Beer website, is another way to introduce Taza to consumers who appreciate quality foods and drinks.

Taza's marketing communications focus mainly on Facebook, Twitter, blogs, e-mail, and specialty food shows. Also, the company frequently offers samples in upscale and organic food stores in major metropolitan areas. As it does with its growers, Taza seeks to forge personal relationships with its channel partners. "When we send a shipment of chocolate," says the sales director, "sometimes we'll put in a little extra for the people who work there. That always helps because [it's] building that kind of human relationship."

Privately-owned Taza has begun shipping to Canada and a handful of European countries. Its channel arrangements must allow for delivering perishable products that stay fresh and firm, no matter what the weather. As a result, distributors often hold some Taza inventory in refrigerated warehouses to have ready for next-day delivery when retailers place orders.[37]

Questions for Discussion

1. Which distribution channels does Taza use, and why are they appropriate for this company?
2. In what ways does Taza benefit from selling directly to some consumers? What are some potential problems of selling directly to consumers?
3. In what ways are Taza's distribution efforts influenced by the fact that its products are organic?

Case 14.2

Procter & Gamble Tunes Up Channels and Transportation

From Duracell to Dawn, Pampers to Prilosec, Procter & Gamble markets some of the world's best-known brands for household needs, health care, personal care, and baby care. Its portfolio includes 25 brands that bring in more than $1 billion each every year, plus another 15 that bring in at least $500 million every year. In all, Procter & Gamble rings up $84 billion in sales through traditional stores and online retailers in 180 countries.

Because nearly all of Procter & Gamble's products are convenience goods, the company uses intensive distribution market coverage. Among the retailers that carry its products are supermarkets, drug stores, convenience stores, discount stores, and warehouse clubs. Shelf space is valuable, so not all stores carry the entire product line in any given category. In many stores, Procter & Gamble's branded items compete for shelf space not only with other manufacturers' brands, but also with store brands. This isn't always the case, however. For example, Procter & Gamble recently signed an exclusive distribution arrangement with Sam's Club, making Duracell the only national brand of batteries sold in those warehouse stores. And, knowing that warehouse stores have limited back-room storage space, Procter & Gamble makes more frequent deliveries to ensure that its products are always in stock for club members.

Eyeing long-term growth in emerging markets, which already account for 40 percent of its sales, Procter & Gamble is always looking for a distribution edge that will put its products on more shelves. When the company acquired Gillette in 2005, it also obtained access to the marketing channels Gillette had established for its razors, blades, and other accessories. This helped Procter & Gamble gain additional distribution for a wider range of products in India and Brazil, among other nations.

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Procter & Gamble is testing new Internet and mobile channels for some of its everyday products. In one Toronto experiment, it teamed with the online retailer Well.ca to create posters of frequently-purchased products like Crest toothpaste and Pampers disposable diapers, along with QR (quick response) codes that can be scanned by consumers with QR apps on their smartphones. The posters were positioned in a busy downtown building adjacent to the subway, where time-pressured commuters could take a minute or two to scan the items they wanted to purchase and arrange delivery from Well.ca at a convenient hour. In another Toronto experiment, Procter & Gamble teamed with Walmart Canada to create virtual stores inside 50 bus shelters. As consumers waited for a bus, they used their smartphones to scan QR codes for baby products, beauty products, and other merchandise, and set a time for later delivery. Tests such as these help both the manufacturer and retailers to refine future marketing efforts as technology evolves.

In addition, the Internet retailing pioneer Amazon.com has asked Procter & Gamble to help it speed up delivery of products sold online. At Amazon's request, Procter & Gamble has roped off a small, separate area inside seven of its distribution centers, reserving this space just for the use of Amazon. These centers in the United States, Japan, and Germany hold cartons and cartons of bulky products like Pampers disposable diapers and Bounty paper towels while they await delivery to retailers. Instead of trucking these goods to Amazon's distribution centers when needed, Procter & Gamble simply shifts them to the separate Amazon section of the building. There, Amazon employees select individual items to fulfill customer orders and ship the boxes directly from the distribution center to consumers. Not only does this save time, but it also saves money for both Procter & Gamble and Amazon.

Efficiency is vital when a marketer like Procter & Gamble distributes products in such massive quantities. In North America alone, the company prepares 800,000 shipments annually for delivery to retailers' warehouses and distribution centers. Shaving even a few dollars per shipment adds up to a significant savings over time. Greener transportation is also helping Procter & Gamble save money while it helps protect the planet. Although the company maintains a small fleet of trucks, most of its products are transported by 80 outside trucking companies. Procter & Gamble is working with the truckers to significantly increase the percentage of shipments transported by vehicles that run on compressed natural gas, making physical distribution greener in environmental and financial terms.[38]

Questions for Discussion

1. Do you think Procter & Gamble should use a direct channel to sell to consumers? Identify one or more arguments for and against using a direct channel for disposable diapers and paper towels.
2. What issues in channel conflict might arise from Procter & Gamble's special arrangements with Amazon .com?
3. Would you recommend that Procter & Gamble use any mode of transportation other than trucks to transport cartons to retailers? Explain your answer.

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