16

Distribution Strategies

The art of getting rich consists not in industry, much less in saving, but in a better order, in timeliness, in being at the right spot.

RALPH WALDO EMERSON

Distribution strategies are concerned with the channels a firm may employ to make its goods and services available to customers. **Channels** are organized structures of buyers and sellers that bridge the gap of time and space between the manufacturer and the customer.

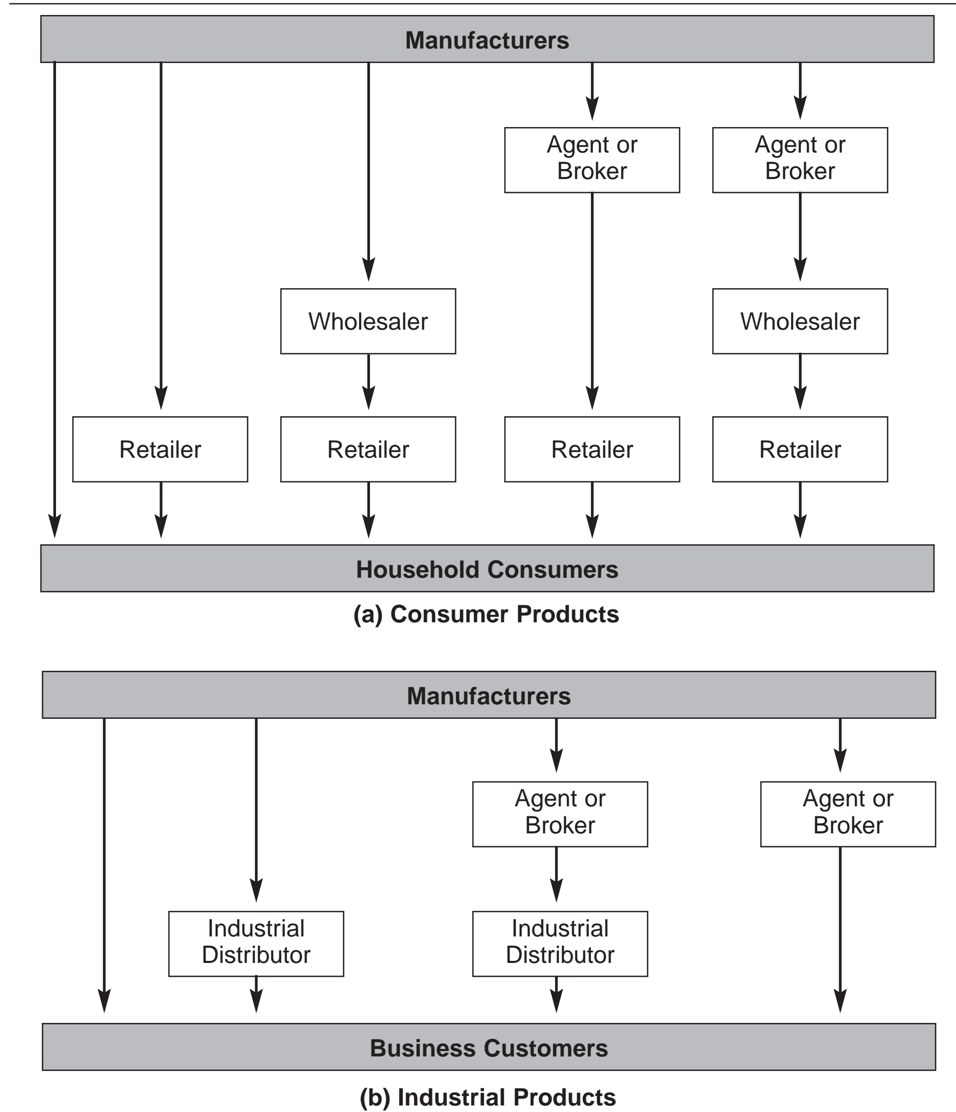
Marketing is defined as an exchange process. In relation to distribution, exchange poses two problems. First, goods must be moved to a central location from the warehouses of producers who make heterogeneous goods and who are geographically widespread. Second, the goods that are accumulated from diversified sources should represent a desired assortment from the viewpoint of customers. These two problems can be solved by the process of sorting, which combines concentration (i.e., bringing the goods from different sources to a central location) and dispersion (i.e., picking an assortment of goods from different points of concentration). Two basic questions need to be answered here. Who should perform the concentration and dispersion tasks—the manufacturer or intermediaries? Which intermediary should the manufacturer select to bring goods close to the customer? These questions are central to distribution strategies.

Other strategy-related matters discussed in this chapter include scope of distribution (i.e., how widespread distribution may be), use of multiple channels to serve different segments, modification of channels to accommodate environmental shifts, resolution of conflict among channels, and use of vertical systems to institute control over channels. Each strategic issue is examined for its relevance in different circumstances. The application of each strategy is illustrated with examples from marketing literature.

CHANNEL-STRUCTURE STRATEGY

The **channel-structure strategy** refers to the number of intermediaries that may be employed in moving goods from manufacturers to customers. A company may undertake to distribute its goods to customers or retailers without involving any intermediary. This strategy constitutes the shortest channel and may be labeled a *direct distribution strategy*. Alternatively, goods may pass through one or more intermediaries, such as wholesalers or agents. This is an *indirect distribution strategy*. Exhibit 16-1 shows alternative channel structures for consumer and industrial products.

EXHIBIT 16-1
Typical Channel Structures



Decisions about channel structure are based on a variety of factors. To a significant extent, channel structure is determined by where inventories should be maintained to offer adequate customer service, fulfill required sorting processes, and still deliver a satisfactory return to channel members.

An underlying factor in determining channel-structure strategy is the use of intermediaries. The importance of using intermediaries is illustrated with reference to an example of a primitive economy used by Alderson.[1] In a primitive

economy, five producers produce one type of item each: hats, hoes, knives, baskets, or pots. Because each producer needs all the other producers' products, a total of 10 exchanges are required to accomplish trade. However, with a market (or middlemen), once the economy reaches equilibrium (i.e., each producer-consumer has visited the market once), only five exchanges need to take place to meet everyone's needs. Let n denote the number of producer-consumers. Then the total number of transactions (T) without a market is given by:

$$T_{\text{without}} = \frac{n(n-1)}{2}$$

and the total number of transactions with a market is given by:

$$T_{\text{with}} = n$$

The efficiency created in distribution by using an intermediary may be viewed using this equation:

$$\text{Efficiency} = \frac{T_{\text{without}}}{T_{\text{with}}} = \frac{n(n-1)}{2} \times \frac{1}{n} = \frac{n-1}{2}$$

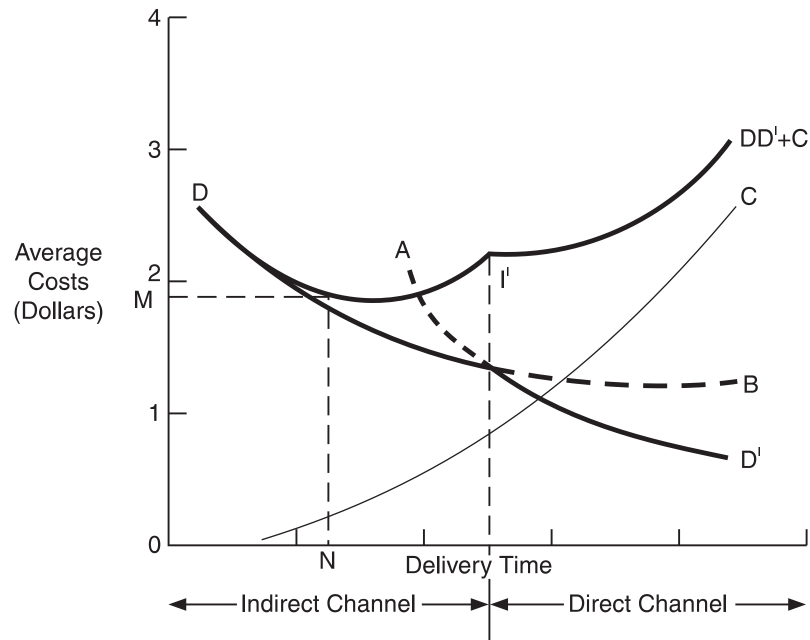
In the example of five producer-consumers, the efficiency of having a middleman is 2. The efficiency increases as n increases. Thus, in many cases, intermediaries may perform the task of distribution more efficiently than manufacturers alone.

Postponement-Speculation Theory

Conceptually, the selection of channel structure may be explained with reference to Bucklin's postponement-speculation framework.[2] The framework is based on risk, uncertainty, and costs involved in facilitating exchanges. Postponement seeks to eliminate risk by matching production/distribution with actual customer demand. Presumably, postponement should produce efficiency in marketing channels. For example, the manufacturer may produce and ship goods only on confirmed orders. Speculation, on the other hand, requires undertaking risk through changes in form and movement of goods within channels. Speculation leads to economies of scale in manufacturing, reduces costs of frequent ordering, and eliminates opportunity cost.

Exhibit 16-2 shows the behavior of variables involved in the postponement-speculation framework. The vertical axis shows the average cost of undertaking a function for one unit of any given commodity; the horizontal axis shows the time involved in delivering a confirmed order. Together, the average cost and the delivery time measure the cost of marketing tasks performed in a channel with reference to delivery time. The nature of the three curves depicted in Exhibit 16-2 should be understood: C represents costs to the buyer for holding an inventory; AD´, costs involved in supplying goods directly from a manufacturer to a buyer; and DB, costs involved in shipping and maintaining speculative inventories (i.e., in anticipation of demand).

EXHIBIT 16-2
Using the Postponement-Speculation Concept to Determine Channel Structure



Source: Louis P. Bucklin and Leslie Halpert, "Exploring Channels of Distribution for Cement with the Principle of Postponement-Speculation," in *Marketing and Economic Development*, ed. Peter D. Bennett (Chicago: American Marketing Association, 1965): 698. Reprinted by permission of the American Marketing Association.

Following Bucklin's framework, one determines the channel structure by examining the behavior of the C, AD', and DB curves:

1. The minimal cost of supplying the buyer for every possible delivery time is derived from curves AD' and DB. As may be seen in Exhibit 16-2, especially fast delivery service can be provided only by the indirect channel (i.e., by using a stocking intermediary). However, at some delivery time, I', the cost of serving the consumer directly from the producer will intersect and fall below the cost of indirect shipment. The minimal costs derived from both curves are designated DD'. From the perspective of channel cost, it will be cheaper to service the buyer from a speculative inventory if delivery times shorter than I' are demanded. If the consumer is willing to accept delivery times longer than I', then direct shipment will be the least expensive.
2. The minimal total cost curve for the channel with respect to delivery time is derived by summing the cost of moving goods to the buyer, DD', and the buyer's costs of holding inventory, C. The curve is represented in Exhibit 16-2 by DD' + C. Total channel costs initially fall as delivery time lengthens because increased buyer expenses are more than made up for by savings in other parts of the channel. Gradually, however, the savings from these sources diminish and buyer costs

> begin to rise more rapidly. A minimal cost point is reached, and expenses for the channel rise thereafter. Channel structure is controlled by the location of this minimum point. If, as in the present case, it falls to the left of I′, then goods would be expected to flow through the speculative inventory (i.e., an intermediary). If, on the other hand, the savings of the buyer from postponement had not been as great as those depicted, the minimum point would have fallen to the right of I′ and shipments would have been made directly from the producer to the consumer.[3]

Benetton, an Italian apparel maker, offers an excellent example of a distribution strategy that combines speculation with postponement in an effort to optimize both service and cost. Speculation involves commitment by retailers to specific inventory items months before the start of the selling season. It leads to such advantages for Benetton as low-cost production (via use of subcontractors) and good quality control (via centralized warehousing and assembly of orders). Postponement of orders requires last-minute dyeing of woolen items at an added cost. The advantages of speculation are flexibility in meeting market needs and reduced inventory levels.[4]

Additional Consideration in Determining Channel Structure

The postponement-speculation theory provides an economic explanation of the way the channels are structured. Examined in this section are a variety of environmental influences on channel-structure strategy formulation. These influences may be technological, social and ethical, governmental, geographical, or cultural.

Many aspects of channel structure are affected by technological advances. For example, mass retailing in food has become feasible because of the development of automobiles, highways, refrigerated cars, cash registers, packaging improvements, and mass communications (television). In the coming years, television shopping with household computer terminals should have a far-reaching impact on distribution structures.[5] Technological advances permitted Sony to become dominant in the U.S. market for low-priced CD players. Sony developed prepackaged players that could be sold through mass retailers so that even sales clerks without technical know-how could handle customers.

How technology may be used to revamp the operations of a wholesaler, making it worthwhile to adopt indirect channels, is illustrated by the case of Foremost-McKesson, the nation's largest wholesale distributor. A few years ago, the company found itself in a precarious position. Distribution, though one of the company's most pervasive business functions, did not pay. Foremost-McKesson merely took manufacturers' goods and resold them to small retailers through a routine process of warehousing, transportation, and simple marketing that offered thin profits. As a matter of fact, at one time the company came close to selling off drug wholesaling, its biggest business. Instead, however, its new chief executive decided to add sophisticated technology to its operations in order to make the company so efficient at distribution that manufacturers could not possibly do as well on their own. It virtually redefined the function of the intermediary. Having used the computer to make its own operations efficient, it devised ways to make its data processing useful to suppliers and customers, in essence

making Foremost part of their marketing teams. Since the company computerized its operations, Foremost has turned around dramatically. Here are the highlights of Foremost's steps in reshaping its role:

- Acting as middleman between drugstores and insurance offices by processing medical insurance claims.
- Creating a massive "rack jobbing" service by providing crews to set up racks of goods inside retail stores, offering what amounts to a temporary labor force that brings both marketing know-how and Foremost merchandise along with it.
- Taking waste products as well as finished goods from chemical manufacturers, and recycling the wastes through its own plants—-its first entry into chemical waste management.
- Designing, as well as supplying, drugstores.
- Researching new uses for products it receives from manufacturers. Foremost found new customers, for example, for a Monsanto Co. food preservative from among its contacts in the cosmetics industry.[6]

Another example of the use of technology to overhaul distribution is provided by Britain's supermarket chain Tesco. The firm's nine composite (variable temperature) distribution centers use a just-in-time system (known as pick-by-line or cross-docking). That means goods amounting to around 40% of total sales go straight out to the stores within hours of arrival.[7]

Social taboos and ethical standards may also affect the channel-structure decision. For example, Mallen reports that *Viva*, a woman's magazine, had achieved a high circulation in supermarkets and drugstores in Canada. When *Viva* responded to readers' insistence and to competition from *Playgirl* by introducing nude male photos, most supermarkets banned the magazine. Because supermarkets accounted for more than half of *Viva's* circulation, *Viva* dropped the photos so that it could continue to be sold through this channel.

The channel-structure strategy can also be influenced by local, state, and federal laws in a variety of ways. For example, door-to-door selling of certain goods may be prohibited by local laws. In many states (e.g., California and Ohio) wine can be sold through supermarkets, but other states (e.g., Connecticut) do not permit this.

Geographic size, population patterns, and typology also influence the channel-structure strategy. In urban areas, direct distribution to large retailers may make sense. Rural areas, however, may be covered only by wholesalers.

With the inception of large grocery chains, it may often appear that independent grocery stores are dying. The truth is, however, that independent grocery stores as recently as 1992 accounted for 46 percent of all grocery sales in the country—over $175 billion. Thus, a manufacturer can ill afford not to deal with independents and to reach them it must go through wholesalers. Wetterau, for example, is a grocery wholesale firm in Hazelwood, Missouri, which did over $6 billion worth of business serving almost 3,000 retail grocery stores. It does not do any business with chain stores. But because of Wetterau's determination to offer its customers relatively low prices, a wide selection of brands, service programs carefully designed to make brands more profitable, and a personal interest in

their success, its customers are almost fanatically loyal. The company offers its customers—small independent retail stores—a variety of services, including lease arrangements, store design, financing packages, training, and computerized inventory systems. These services tend to enhance customers' competitiveness by reducing their operating costs and by simplifying their bookkeeping, which in turn helps Wetterau to earn profits.[8] The Wetterau example shows that to reach smaller retailers, particularly in areas far removed from large metropolises, the indirect distribution strategy is appropriate. The wholesaler provides services to small retailers that a large manufacturer can never match on its own.

Finally, cultural traits may require the adoption of a certain channel structure in a setting that otherwise might seem an odd place for it. For example, in many parts of Switzerland, fruits and vegetables are sold in a central marketplace in the morning by small vendors, even though there are modern supermarkets all over. This practice continues because it gives customers a chance to socialize while shopping. Similarly, changing lifestyles among average American consumers and their desire to have more discretionary income for life-fulfillment activities appear to be making warehouse retailing (e.g., Sam's Club) more popular. This is so because prices at warehouse outlets—grocery warehouses, for example—are substantially lower than at traditional stores.

Channel Design Model

Presented below is a channel design model that can be used to make the direct/indirect distribution decision. The model involves six basic steps.

1. List the factors that could potentially influence the direct/indirect decision. Each factor must be evaluated carefully in terms of the firm's industry position and competitive strategy.
2. Pick out the factors that will have the most impact on the channel design decision. No factor with a dominant impact should be left out. For example, assume that the following four factors have been identified as having particular significance: market concentration, customer service level, asset specificity, and availability of working capital.
3. Decide how each factor identified is related to the attractiveness of a direct or an indirect channel. For example, market concentration reflects the size distribution of the firm's customers as well as their geographical dispersion. Therefore, the more concentrated the market, the more desirable the direct channel because of the lower costs of serving that market (high = direct; low = indirect). Customer service level is made up of at least three factors: delivery time, lot size, and product availability. The more customer service required by customers, the less desirable is the direct channel (high = indirect; low = direct). The direct channel is more desirable, at least under conditions of high uncertainty in the environment, with a high level of asset specificity (high = direct; low = indirect). Finally, the greater the availability of working capital, the more likely it is that a manufacturer can afford and consider a direct channel (high = direct; low = indirect). Note that a high level on a factor does not always correspond to a direct channel.
4. Create a matrix based on the key factors to consider the interactions among key factors. If only two factors are being considered, a two-by-two matrix of four cells would result. For three factors, a three-by-three matrix of nine cells would result.

For four factors, a four-by-four matrix of sixteen cells would result, and so on. If more than five or six factors are involved, a series of smaller models could be constructed to make this fourth step more manageable. Exhibit 16-3 presents a four-by-four matrix developed for this example.

5. Decide (for each cell in the matrix) whether a direct channel, an indirect channel, or a combination of both a direct and an indirect channel is most appropriate, considering the factors involved. Combination channels are becoming more common in business practice, especially in industrial markets.

   For some cells in the matrix, deciding which channel design is best is rather easy to do. For example, Cell 1 in Exhibit 16-3 has all four factors in agreement that an indirect channel is best. This is also true for Cell 16: a direct channel is the obvious choice. For other cells, choosing between a direct channel and an indirect channel is not as easy because factors conflict with each other to some extent. For example, in Cell 14, asset specificity is low, suggesting that an indirect channel is best. The other three factors suggest otherwise, however; the market is concentrated, customer service requirements are low, and the availability of capital to the manufacturer is high. Taken together, the factors in Cell 14 reveal that a direct channel would be most attractive. In the cells that have factors that conflict with one another, the strategist must make trade-offs among them to decide whether a direct channel, indirect channel, or combination of channels is best.

EXHIBIT 16-3
Designing a Distribution Channel Matrix

			Asset Specificity			
			Low		High	
			Capital Availability		Capital Availability	
Market Concentration	Customer Service Level		Low	High	Low	High
Low	Customer Service Level	High	*cell 1* indirect	*cell 3* indirect	*cell 2* indirect	*cell 4* combination
Low	Customer Service Level	Low	*cell 5* indirect	*cell 7* combination	*cell 6* combination	*cell 8* direct
High	Customer Service Level	High	*cell 9* indirect	*cell 11* combination	*cell 10* direct	*cell 12* direct
High	Customer Service Level	Low	*cell 13* combination	*cell 15* combination	*cell 14* direct	*cell 16* direct

Source: Gary L. Frazier, "Designing Channels of Distribution," *The Channel for Communication* (Seattle, Wash.: Center for Retail Distribution Management, University of Washington, 1987): 3–7.

6. For each product or service in question, locate the corresponding cell in the box model. The prediction in this cell is the one that should be followed or at least the one that should be most seriously considered by the firm.

The accuracy of the model generated by this method depends totally on the expertise and skills of the person who builds and uses it. If carefully constructed, such a model can be invaluable in designing more efficient and effective channels of distribution.[9]

DISTRIBUTION-SCOPE STRATEGY

For an efficient channel network, the manufacturer should clearly define the target customers it intends to reach. Implicit in the definition of target customers is a decision about the scope of distribution the manufacturer wants to pursue. The strategic alternatives here are exclusive distribution, selective distribution, and intensive distribution.

Exclusive Distribution

Exclusive distribution means that one particular retailer serving a given area is granted sole rights to carry a product. For example, Coach leather goods are distributed exclusively through select stores in an area. Several advantages may be gained by the use of exclusive distribution. It promotes tremendous dealer loyalty, greater sales support, a higher degree of control over the retail market, better forecasting, and better inventory and merchandising control. The impact of dealer loyalty can be helpful when a manufacturer has seasonal or other kinds of fluctuating sales. An exclusive dealership is more willing to finance inventories and thus bear a higher degree of risk than a more extensive dealership. Having a smaller number of dealers gives a manufacturer or wholesaler greater opportunity to provide each dealer with promotional support. And with fewer outlets, it is easier to control such aspects as margin, price, and inventory. Dealers are also more willing to provide data that may be used for marketing research and forecasts. Exclusive distribution is especially relevant for products that customers seek out. Examples of such products include Rolex watches, Gucci bags, Regal shoes, Celine neckties, and Mark Cross wallets.

On the other hand, there are several obvious disadvantages to exclusive distribution. First, sales volume may be lost. Second, the manufacturer places all its fortunes in a geographic area in the hands of one dealer. Exclusive distribution brings with it the characteristics of high price, high margin, and low volume. If the product is highly price elastic in nature, this combination of characteristics can mean significantly less than optimal performance. Relying on one retailer can mean that if sales are depressed for any reason, the retailer is then likely to be in a position to dictate terms to other channel members (i.e., the retailer becomes the channel captain).

For example, assume that a company manufacturing traditional toys deals exclusively with Toys “R” Us. For a variety of reasons, its line of toys may not do well. These reasons may be a continuing decline in the birthrate, an economic

recession, the emerging popularity of electronic toys, higher prices of the company's toys compared to competitive brands, a poor promotional effort by Toys "R" Us, and so on. Because it is the exclusive distributor, however, Toys "R" Us may put the blame on the manufacturer's prices, and it may demand a reduction in prices from the manufacturer. Inasmuch as the manufacturer has no other reasons to give that could explain its poor performance, it must depend on Toys "R" Us's analysis.

The last disadvantage of exclusive distribution is one that is easy to overlook. In certain circumstances, exclusive distribution has been found to be in violation of antitrust laws because of its restraint on trade. The legality of an exclusive contract varies from case to case. As long as an exclusive contract does not undermine competition and create a monopoly, it is acceptable. The courts appear to use the following criteria to determine if indeed an exclusive distribution lessens competition:

1. Whether the volume of the product in question is a substantial part of the total volume for that product type.
2. Whether the exclusive dealership excludes competitive products from a substantial share of the market.

Thus, a company considering an exclusive distribution strategy should review its decision in the light of these two ground rules.

Intensive Distribution

The inverse of exclusive distribution is intensive distribution. **Intensive distribution** makes a product available at all possible retail outlets. This may mean that the product is carried at a wide variety of different and also competing retail institutions in a given area. The distribution of convenience goods is most consistent with this strategy. If the nature of a product is such that a consumer generally does not bother to seek out the product but will buy it on sight if available, then it is to the seller's advantage to have the product visible in as many places as possible. The Bic Pen Corporation is an example of a firm that uses this type of strategy. Bic makes its products available in a wide variety of retail establishments, ranging from drugstores, to "the corner grocery store," to large supermarkets. In all, Bic sells through 250,000 retail outlets, which represent competing as well as noncompeting stores. The advantages to be gained from this strategy are increased sales, wider customer recognition, and impulse buying. All of these qualities are desirable for convenience goods.

There are two main disadvantages associated with intensive distribution. First, intensively distributed goods are characteristically low-priced and low-margin products that require a fast turnover. Second, it is difficult to provide any degree of control over a large number of retailers. In the short run, uncontrolled distribution may not pose any problem if the intensive distribution leads to increased sales. In the long run, however, it may have a variety of devastating effects. For example, if durable products such as Sony television sets were to be intensively distributed (i.e., through drugstores, discount stores, variety stores, etc.), Sony's sales would probably increase. But such intensive distribution could lead to the problems of price discounting, inadequate customer service, and noncooperation

among traditional channels (e.g., department stores). Not only might these problems affect sales revenues in the long run, but the manufacturer might also lose some of its established channels. For example, a department store might decide to drop the Sony line for another brand of television sets. In addition, Sony's distinctive brand image could suffer. In other words, the advantages furnished by intensive distribution should be related carefully to product type to decide if this form of distribution is suitable. It is because of the problems outlined above that one finds intensive distribution limited to such products as candy, newspapers, cigarettes, aspirin, and soft drinks. For these types of products, turnover is usually high and channel control is usually not as strategic as it would be, say, for television sets.

Selective Distribution

Between exclusive and intensive distribution, there is selective distribution. **Selective distribution** is the strategy in which several but not all retail outlets in a given area distribute a product. **Shopping goods**—goods that consumers seek on the basis of the most attractive price or quality characteristics—are frequently distributed through selective distribution. Because of this, competition among retailers is far greater for shopping goods than for convenience goods. Naturally, retailers wish to reduce competition as much as possible. This causes them to pressure manufacturers to reduce the number of retail outlets in their area distributing a given product in order to reduce competition.

The number of retailers under a selective distribution strategy should be limited by criteria that allow the manufacturer to choose only those retailers who will make a contribution to the firm's overall distribution objectives. For example, some firms may choose retail outlets that can provide acceptable repair and maintenance service to consumers who purchase their products. In the automotive industry, selective criteria are used by manufacturers in granting dealerships. These criteria consist of such considerations as showroom space, service facilities, and inventory levels.

The point may be illustrated with reference to Pennsylvania House, a furniture company. The company used to have 800 retail accounts, but it cut this number to 500. This planned cut obviously limited the number of stores in which the company's product line was exposed. More limited distribution provided the company with much stronger support among surviving dealers. Among these 500 dealers, there was a higher average amount of floor space devoted to Pennsylvania House merchandise, better customer service, better supplier relations, and most important for the company, substantially increased sales per account.

Selective distribution is best applied under circumstances in which high sales volume can be generated by a relatively small number of retailers or, in other words, in which the manufacturer would not appreciably increase its coverage by adding additional dealers. Selective distribution can also be used effectively in situations in which a manufacturer requires a high-caliber firm to carry a full product line and provide necessary services. A dealer in this position is likely to require promotional and technical assistance. The technical assistance is needed not only in conjunction with the sale but also after the sale in the form of repair

and maintenance service. Again, by limiting the number of retail outlets to a select few capable of covering the market, the manufacturer can avoid unnecessary costs associated with signing on additional dealers.

Obviously, the greatest danger associated with a strategy of selective distribution is the risk of not adequately covering the market. The consequences of this error are greater than the consequences of initially having one or two extra dealers. Therefore, when in doubt, it is better to have too much coverage than not enough.

In selective distribution, it is extremely important for a manufacturer to choose dealers (retailers) who most closely match the marketing goals and image intended for the product. There can be segments within retail markets; therefore, identifying the right retailers can be the key to penetrating a chosen market. Every department store cannot be considered the same. Among them there can be price, age, and image segmentation. One does not need to be very accurate in distinguishing among stores of the same type in the case of products that have no special image (i.e., those that lend themselves to unsegmented market strategies and mass distribution). But for products with any degree of fashion or style content or with highly segmented customer groups, a selective distribution strategy requires a careful choice of outlets.

To appraise what type of product is suitable for what form of distribution, refer to Exhibit 16-4. This exhibit combines the traditional threefold classification of consumer goods (convenience, shopping, and specialty goods) with a threefold classification of retail stores (convenience, shopping, and specialty stores) to determine the appropriate form of distribution. This initial selection may then be examined in the light of other considerations to make a final decision on the scope of distribution.

MULTIPLE-CHANNEL STRATEGY

The multiple-channel strategy refers to a situation in which two or more different channels are employed to distribute goods and services. The market must be segmented so that each segment gets the services it needs and pays only for them, not for services it does not need. This type of segmentation usually cannot be done effectively by direct selling alone or by exclusive reliance upon distributors. The Robinson-Patman Act makes the use of price for segmentation almost impossible when selling to the same kind of customer through the same distribution channel. Market segmentation, however, may be possible when selling directly to one class of customer and to another only through distributors, which usually requires different services, prices, and support. Thus, a multiple-channel strategy permits optimal access to each individual segment.

Basically, there are two types of multiple channels of distribution, complementary and competitive.

Complementary Channels

Complementary channels exist when each channel handles a different noncompeting product or noncompeting market segment. An important reason to promote

EXHIBIT 16-4
Selection of Suitable Distribution Policies Based on the Relationship between Type of Product and Type of Store

Classification	*Consumer Behavior*	*Most Likely Form of Distribution*
Convenience store/ convenience good	The consumer prefers to buy the most readily available brand of a product at the most accessible store.	Intensive
Convenience store/shopping good	The consumer selects his or her purchase from among the assortment carried by the most accessible store.	Intensive
Convenience store/specialty good	The consumer purchases his or her favorite brand from the most accessible store carrying the item in stock.	Selective/ exclusive
Shopping store/ convenience good	The consumer is indifferent to the brand of product he or she buys but shops different stores to secure better retail service and/or retail price.	Intensive
Shopping store/shopping good	The consumer makes comparisons among both retail-controlled factors and factors associated with the product (brand).	Intensive
Shopping store/specialty good	The consumer has a strong preference as to product brand but shops a number of stores to secure the best retail service and/or price for this brand.	Selective/ exclusive
Specialty store/convenience good	The consumer prefers to trade at a specific store but is indifferent to the brand of product purchased.	Selective/ exclusive
Specialty store/shopping good	The consumer prefers to trade at a certain store but is uncertain as to which product he or she wishes to buy and examines the store's assortment for the best purchase.	Selective/ exclusive
Specialty store/specialty good	The consumer has both a preference for a particular store and for a specific brand.	Selective/ exclusive

Source: Louis P. Bucklin, "Retail Strategy and the Classification of Consumer Goods," *Journal of Marketing* (January 1963): 50–55; published by the American Marketing Association.

complementary channels is to reach market segments that cannot otherwise be served. For example, Avon Products, which had sold directly to consumers for 100 years, broke the tradition in 1986 and began selling some perfumes (e.g., Deneuve fragrance, which sells for as much as $165 an ounce) through department stores. The rationale behind this move was to serve customer segments that the company could not reach through direct selling.[10] Samsonite Corporation sells the same type of luggage to discount stores that it distributes through department stores, with some cosmetic changes in design. In this way the company is able to reach middle- and low-income segments that may never shop for luggage in department stores. Similarly, magazines use newsstand distribution as a complementary channel to subscriptions. Catalogs serve as complementary channels for large retailers such as J.C. Penney.

The simplest way to create complementary channels is through private branding. This permits entry into markets that would otherwise be lost. The Coca-Cola Company sells its Minute Maid frozen orange juice to A&P to be sold under the A&P name. At the same time, the Minute Maid brand is available in A&P stores. Presumably, there are customers who perceive the private brand to be no different in quality from the manufacturer's brand. Inasmuch as the private brand is always a little less expensive than a manufacturer's brand, such customers prefer the lower-priced private brand. Thus, private branding helps broaden the market base.

There is another reason that may lead a manufacturer to choose this strategy. In instances where other firms in an industry have saturated traditional distribution channels for a product, a new entry may be distributed through a different channel. This new channel may then in turn be different from the traditional channel used for the rest of the manufacturer's product line. Hanes, for example, decided to develop a new channel for L'eggs (supermarkets and drugstores) because traditional channels were already crowded with competing brands. Likewise, R. Dakin developed nontraditional complementary channels to distribute its toys. Although most toy manufacturers sell their wares through toy shops and department stores, Dakin distributes more than 60 percent of its products through a variety of previously ignored outlets such as airports, hospital gift shops, restaurants, amusement parks, stationery stores, and drugstores. This strategy lets Dakin avoid direct competition. In recent years, many companies have developed new channels in the form of direct mail sales for such diverse products as men's suits, shoes, insurance, records, newly published books, and jewelry.

Still yet to come is electronic commerce. The Internet is going to change where and how consumers shop and retailers sell. It will become the location to buy almost anything a person wants—fast, easy, and whenever he/she wants it. But that does not mean that traditional retail stores will become relics. For one thing, it is going to be a long time before the majority of consumers do most of their shopping on the Web. Further, the physical limits of buying on the Web mean that not every product is suited to online purchasing.[11]

U.S. consumers spent $5 billion on purchases on the Web in 1997. The number was likely to be $11 billion in 1998, and would soar to $95 billion in 2002. As

personal computers and online services penetrate more and more households, the number of cybershoppers will grow. By 2002, 22% of U.S. households will use Internet services, and 30% are expected to use the Internet to do a large part of their shopping.[12]

A company may also develop complementary channels to broaden the market when its traditional channel happens to be a large account. For example, Easco Corporation, the nation's second-largest maker of hand tools, had for years tied itself to Sears, Roebuck and Company, supplying wrenches, sockets, and other tools for the retailer's Craftsman line. Sears accounted for about 47 percent of Easco's sales and about 62 percent of its pretax earnings in the mid-1980s. But as Sears's growth slowed, Easco had a critical strategic dilemma: What do you do when one dominant customer stops growing and starts to slip? The company decided to lessen its dependence on Sears by adding some 500 new hardware and home-center stores for its hand tools.[13]

To broaden their markets in recent years, many clothing manufacturers, including Ralph Lauren, Liz Claiborne, Calvin Klein, Anne Klein, and Adrienne Vittadini, have opened their own stores to sell a full array of their clothes and accessories.[14] Again, to broaden the market, brand-name fast-food companies, Pizza Hut, Subway Sandwiches, Salads Kiosk, and others, have started selling their products in public school cafeterias.[15]

Complementary channels may also be necessitated by geography. Many industrial companies undertake direct distribution of their products in such large metropolitan areas as New York, Chicago, Detroit, and Cleveland. Because the market is dense and because of the proximity of customers to each other, a salesperson can make more than 10 calls a day. The same company that sells directly to its customers in urban environments, however, may use manufacturer's representatives or some other type of intermediary in the hinterlands because the market there is too thin to support full-time salespeople.

Another reason to promote complementary channels is to enhance the distribution of noncompeting items. For example, many food processors package fruits and vegetables for institutional customers in giant cans that have little market among household customers. These products, therefore, are distributed through different channels. Procter & Gamble manufactures toiletries for hotels, motels, hospitals, airlines, and so on, which are distributed through different channel arrangements. The volume of business may also require the use of different channels. Many appliance manufacturers sell directly to builders but use distributors and dealers for selling to household consumers.

The basis for employing complementary channels is to enlist customers and segments that cannot be served when distribution is limited to a single channel. Thus, the addition of a complementary channel may be the result of simple cost-benefit analysis. If by employing an additional channel the overall business can be increased without jeopardizing quality or service and without any negative impact on long-term profitability, it may be worthwhile to do so. However, care is needed to ensure that the enhancement of the market through multiple channels does not lead the Justice Department to charge the company with monopolizing the market.

Competitive Channels

The second type of multiple-channel strategy is the competitive channel. **Competitive channels** exist when the same product is sold through two different and competing channels. This distribution posture may be illustrated with reference to a boat manufacturer, the Luhrs Company. Luhrs sells and ships boats directly to dealers, using one franchise to sell Ulrichsen wood boats and Alura fiberglass boats and another franchise to sell Luhrs wood and fiberglass/wood boats. The two franchises could be issued to the same dealer, but they are normally issued to separate dealers. Competition between dealers holding separate franchises is both possible and encouraged. The two dealers compete against each other to the extent that their products satisfy similar consumer needs in the same segment.

The reason for choosing this competitive strategy is the hope that it will increase sales. It is thought that if dealers must compete against themselves as well as against other manufacturers' dealers, the extra effort will benefit overall sales. The effectiveness of this strategy is debatable. It could be argued that a program using different incentives, such as special discounts for attaining certain levels of sales, could be just as effective as this type of competition. It could be even more effective because the company would eliminate costs associated with developing additional channels.

Sometimes a company may be forced into developing competing channels in response to changing environments. For example, nonprescription drugs were traditionally sold through drugstores. But as the merchandising perspectives of supermarkets underwent a change during the post-World War II period, grocery stores became a viable channel for such products because shoppers expected to find convenience drug products there. This made it necessary for drug companies to deal with grocery wholesalers and retail grocery stores along with drug wholesalers and drugstores. In the 1980s, Capital Holding Corp. (a life insurance company located in Louisville, Kentucky) adopted a variety of marketing innovations. For example, in 1985 it began selling life insurance in novel ways, notably through supermarkets. Impressed by Capital Holding's steady growth and strong financial performance, many other insurance companies were forced to develop new channels to sell their insurance products.[16]

The argument behind the competitive channel strategy is that, although two brands of the same manufacturer may be essentially the same, they may appeal to different sets of customers. Thus, General Motors engages different dealers for its Buick, Cadillac, Chevrolet, Oldsmobile, and Pontiac cars. These dealers vigorously compete with one another. A more interesting example of competing multiple channels adopted by automobile manufacturers is provided by their dealings with car rental companies. Carmakers sell cars directly to car rental agencies. Hertz, for example, buys from an assembly plant and regularly resells some of its slightly used cars in competition with new cars through its more than 100 offices across the United States. Many of these offices are located in close proximity to dealers of new cars. Despite such competition, a manufacturer undertakes distribution through multiple channels to come off, on the whole, with increased business.

In adopting multiple competing channels, a company needs to make sure that it does not overextend itself; otherwise it may spread itself too thin and face com-

petition to such an extent that ultimate results are disastrous. McCammon cites the case of a wholesaler who adopted multiple channels and thus exposed itself to a grave situation:

> Consider, for example, the competitive milieu of Stratton & Terstegge, a large hardware wholesaler in Louisville. At the present time, the company sells to independent retailers, sponsors a voluntary group program, and operates its own stores. In these multiple capacities, it competes against conventional wholesalers (Belknap), cash and carry wholesalers (Atlas), specialty wholesalers (Garcia), corporate chains (Wiches), voluntary groups (Western Auto), cooperative groups (Colter), free-form corporations (Interco), and others. Given the complexity of its competitive environment, it is not surprising to observe that Stratton & Terstegge generates a relatively modest rate of return on net worth.[17]

One of the dangers involved in setting up multiple channels is dealer resentment. This is particularly true when competitive channels are established. When this happens, it obviously means that an otherwise exclusive retailer will now suffer a loss in sales. Such a policy can result in the retailer electing to carry a different manufacturer's product line, if a comparable product line is available. For example, if a major department store such as Lord & Taylor is upset with a manufacturer such as the Hathaway Shirt Company for doing business with discounters (i.e., for adopting competing channels), it can very easily give its business to another shirt manufacturer.

Consider the following examples.[18] Hill's Science Diet pet food lost a great deal of support in pet shops and feed stores as a result of the company's experiments with a "store within a store" pet shop concept in the competing grocery channel. In the auto market, ATK, the dominant seller of replacement engines for Japanese cars, lost its virtual monopoly when it attempted to undercut distributors and sell direct to individual mechanics and installers.

Quaker Oats's recent $1.4 billion write-off from the divestiture of its Snapple business was caused in part by channel conflict. Quaker had planned to consolidate its highly efficient grocery channel supporting the Gatorade brand with Snapple's channels for reaching convenience stores. Snapple distributors were supposed to focus on delivering small quantities of both brands to convenience store accounts while Gatorade's warehouse delivery channel handled larger orders to grocery chains and major accounts, leveraging Quaker's established strength in this area.

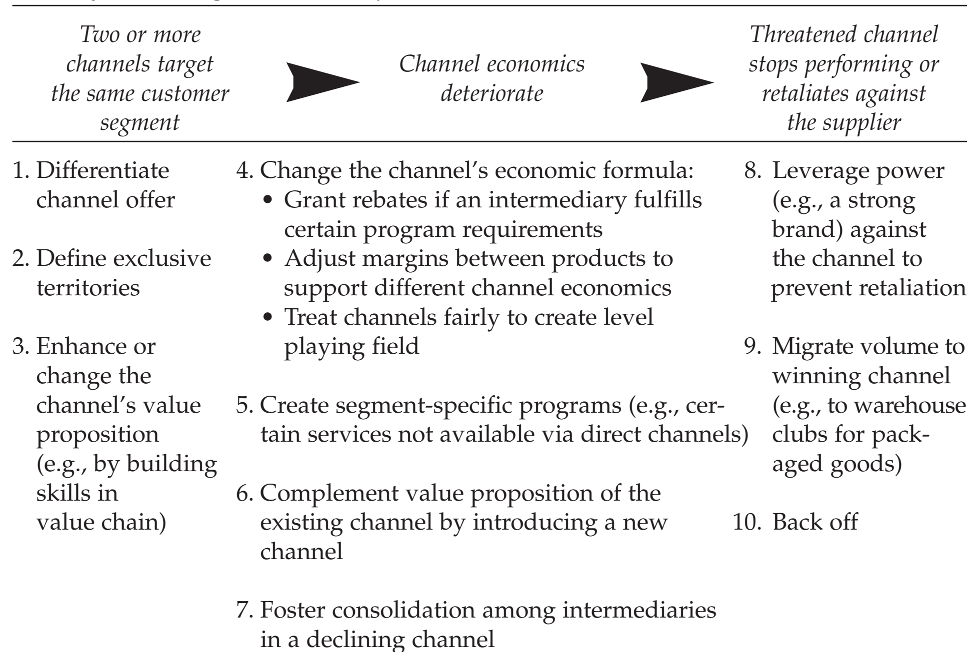
However, the strategy backfired. As Quaker suggested moving larger Snapple accounts to Gatorade's delivery system, Snapple's distributors revolted. They saw the value of their Snapple business as an exclusive geographic franchise that the split channel strategy would undermine. Several Snapple distributors took legal action against Quaker. The company ultimately backed down, but the dispute had created a considerable distraction at a time when competition from Arizona and Nantucket Nectars was intensifying.

Multiple channels also create control problems. National Distillers and Chemical Corporation had a wholly owned New York distributor, Peel Richards,

that strictly enforced manufacturer-stipulated retail prices and refused to do business with price cutters. Since R.H. Macy discounted National Distiller's products, Peel Richards stopped selling to them. R.H. Macy retaliated by placing an order with an upstate New York distributor of National Distillers.[19] National Distillers had no legal recourse against either R.H. Macy or the upstate New York distributor, who was an independent businessperson.

These problems do not diminish the importance of multiple distribution: they only suggest the difficulties that may arise with multiple channels and the difficulties with which management must contend. A manufacturer's failure to use multiple channels gives competitors an opportunity to segment the market by concentrating on one or the other end of the market spectrum. This is particularly disastrous for a leading manufacturer because it must automatically forgo access to a large portion of market potential for not being able to use the economies of multiple distribution. If a manufacturer determines that multiple channels could cause problems, solutions must be found to resolve those problems. Exhibit 16-5 outlines a variety of ways to tackle multiple channel conflicts at different stages in its development.[20] For example, if conflict has recently arisen between channels focused on the same segments, suppliers might respond by introducing separate products or brands tailored to each channel.

EXHIBIT 16-5
Ten Ways to Manage Channel Conflict



Two or more channels target the same customer segment ➤	*Channel economics deteriorate* ➤	*Threatened channel stops performing or retaliates against the supplier*
1. Differentiate channel offer 2. Define exclusive territories 3. Enhance or change the channel's value proposition (e.g., by building skills in value chain)	4. Change the channel's economic formula: • Grant rebates if an intermediary fulfills certain program requirements • Adjust margins between products to support different channel economics • Treat channels fairly to create level playing field 5. Create segment-specific programs (e.g., certain services not available via direct channels) 6. Complement value proposition of the existing channel by introducing a new channel 7. Foster consolidation among intermediaries in a declining channel	8. Leverage power (e.g., a strong brand) against the channel to prevent retaliation 9. Migrate volume to winning channel (e.g., to warehouse clubs for packaged goods) 10. Back off

Source: Christine B. Bucklin, Pamela A. Thomas-Graham, and Elizabeth A. Webster, "Channel Conflict: When Is It Dangerous?" *The McKinsey Quarterly*, No. 3, 1997, p. 38.

CHANNEL-MODIFICATION STRATEGY

The **channel-modification strategy** is the introduction of a change in existing distribution arrangements based on evaluation and critical review. Channels should be evaluated on an ongoing basis so that appropriate modification may be made as necessary.[21] A shift in existing channels may become desirable for any of the following reasons:

1. Changes in consumer markets and buying habits.
2. Development of new needs in relation to service, parts, or technical help.
3. Changes in competitors' perspectives.
4. Changes in relative importance of outlet types.
5. Changes in a manufacturer's financial strength.
6. Changes in the sales volume level of existing products.
7. Changes in product (addition of new products), price (substantial reduction in price to gain dominant position), or promotion (greater emphasis on advertising) strategies.

To illustrate the importance of modifying channel arrangements to keep up with changing climate, consider GM's efforts to remake its distribution system. GM's objective is to catch up with population shifts by moving stores out of small towns and declining cities and into bustling retail zones along suburban highways. At the same time, it is pushing dealers to reconfigure their holdings to match the way GM has realigned its divisions, and either to spiff up stores or build new ones. The company's ultimate goal: fewer but better dealers. Although the auto maker has made progress in revamping the distribution, the going has been tough as expected. GM launched a $1 billion project in 1990 to relocate some dealers, merge others, and shrink its dealer count from 9,500 in 1990 to 7,000 by the end of 2000.[22]

Channel Evaluation

Channels of distribution may be evaluated on such primary criteria as cost of distribution, coverage of market (penetration), customer service, communication with the market, and control of distribution networks. Occasionally, such secondary factors as support of channels in the successful introduction of a new product and cooperation with the company's promotional effort also become evaluative criteria. To arrive at a distribution channel that satisfies all these criteria requires simultaneous optimization of every facet of distribution, something that is usually not operationally possible. Consequently, a piecemeal approach may be followed.

Cost of Distribution. A detailed cost analysis of distribution is the first step in evaluating various channel alternatives on a sales-cost basis. This requires classification of total distribution costs under various heads and subheads. Exhibit 16-6 illustrates such a cost classification based on general accounting practices; information about each item should be conveniently available from the controller's office.

The question of evaluation comes up only when the company has been following a particular channel strategy for a number of years. Presumably, the

EXHIBIT 16-6
Representative List of Distribution Costs by Function

1. Direct Selling

Salaries: administrative and supervisory
Clerical
Salespeople
Commission
Travel and entertainment
Training
Insurance: real and property; liability; workmen's comp
Taxes: personal property; social security; unemployment insurance
Returned-goods expense chargeable to salespeople
Pension
Rent
Utilities
Repair and maintenance
Depreciation
Postage and office supplies

2. Advertising and Sales Promotion

Salaries: administrative and supervisory; clerical; advertising production
Publication space: trade journals; newspapers
Product promotion: advertising supplier; advertising agency fees; direct-mail expenses; contests; catalogs and price list
Cooperative advertising: dealers; retail stores; billboards

3. Product and Package Design

Salaries: administrative and supervisory
Wages
Materials
Depreciation

4. Sales Discounts and Allowances

Cash discounts on sales
Quantity discounts
Sales allowances

5. Credit Extension

Salaries: administrative and supervisory; credit representatives; clerical
Bad debt losses
Forms and postage
Credit rating services
Legal fees: collection efforts
Travel
Financial cost of accounts receivable

6. Market Research

Salaries: administrative; clerical
Surveys: distributors; consumers
Industry trade data
Travel

7. Warehousing and Handling

Salaries: administrative
Wages: warehouse services
Depreciation: furniture; fixtures
Insurance
Taxes
Repair and maintenance
Unsalable merchandise
Warehouse responsibility
Supplies
Utilities

8. Inventory Levels

Obsolescence markdown
Financial cost of carrying inventories

9. Packing, Shipping, and Delivery

Salaries: administrative; clerical
Wages: truck drivers; truck maintenance persons; packers
Shipping clerks
Truck operators
Truck repairs
Depreciation: furniture; fixtures; trucks
Insurance
Taxes
Utilities
Packing supplies
Postage and forms
Freight: factory to warehouse; warehouse to customer; factory to customer
Outside trucking service

10. Order Processing

Order forms
Salaries: administrative
Wages: order review clerks; order processing clerks; equipment operators
Depreciation: Order processing equipment

EXHIBIT 16-6
Representative List of Distribution Costs by Function (continued)

11. Customer Service

Salaries: administrative; customer service representatives; clerical
Stationery and supplies

12. Printing and Recording of Accounts Receivable

Sales invoice forms
Salaries: clerical; administrative; accounts receivable clerks; sales invoicing equipment operators
Depreciation: sales invoicing equipment

13. Returned Merchandise

Freight
Salaries: administrative; clerical; returned-goods clerical
Returned-goods processing: material labor
Forms and supplies

company has pertinent information to undertake distribution cost analysis by customer segment and product line. This sort of data allows the analyzer to find out how cost under each head varies with sales volume; for example, how warehousing expenses vary with sales volume, how packaging and delivery expenses are related to sales, and so on. In other words, the purpose here is to establish a relationship between annual sales and different types of cost. These relationships are useful in predicting the future cost behavior for established dollar-sales objectives, assuming present channel arrangements are continued.

To find out the cost of distribution for alternative channels, estimates should be made of all relevant costs under various sales estimates. Cost information can be obtained from published sources and interviews with selected informants. For example, assume that a company has been selling through wholesalers for a number of years and is now considering distribution through its own branches. To follow the latter course, the company needs to rent a number of offices in important markets. Estimates of the cost of renting or purchasing an office can be furnished by real estate agents. Similarly, the cost of recruiting and hiring additional help to staff the offices should be available through the personnel office. With the relevant information gathered, simple break-even analysis can be used to compute the attractiveness of the alternative channel.

Assume that a company has 20,000 potential customers and, on an average, that each of them must be contacted every two weeks. A salesperson who makes 10 calls a day and who works five days a week can contact 100 customers every two weeks. Thus, the company needs 20,000 ÷ 100 = 200 salespeople. If each salesperson receives $30,000 in salary and $20,000 in expenses, the annual cost of its salespeople is $10,000,000. Further, assume that 10 sales managers are required for control and supervision and that each one is paid, say, $50,000 a year. The cost of supervision would then be $500,000. Let $9,500,000 be the cost of other overhead, such as office and warehouse expenses. The total cost of direct distribution will then be $10,000,000 + $500,000 + $9,500,000, or $20 million.

Assume that distribution through wholesalers (the arrangement currently being pursued) costs the company 25 percent of sales. Assuming sales to be $\$x$, we can set up an equation, $0.25x + \$20$ million, and solve for x ($x + \$80$ million). If the company decides to go to direct distribution, it must generate a sales volume of $80 million before it can break even on costs. Thus, if sales potential is well above the $80 million mark, direct distribution is worth considering.

One problem with break-even analysis is that distribution alternatives that are considered equally effective may not always be so. It is a pervasive belief that the choice of a distribution channel affects total sales revenue just as the selection of an advertising strategy does. For example, a retailer may receive the same number of calls under either of two channel alternatives: from the company's salesperson or from a wholesaler's salesperson. The question, however, is whether the effect of these calls is the same. The best way to handle this problem is to calculate the changes that would be necessary in order to make channel alternatives equally effective. To an extent, this can be achieved either intuitively or by using one of the mathematical models reported in the marketing literature.

Coverage of the Market. An important aspect of predicting future sales response is the penetration that will eventually be achieved in the market. For example, in the case of a drug company, customers can be divided into three groups: (a) drugstores, (b) doctors, and (c) hospitals.

One measure of the coverage of the market (or penetration of the market) is the number of customers in a group contacted or sold, divided by the total number of customers in that group. Another measure may be penetration in terms of geographical coverage of territory. But these measures are too general. Using just the ratio of customers contacted to the total number of customers does not give a proper indication of coverage because not all types of customers are equally important. Therefore, customers may be further classified, as shown in the accompanying display:

Customer Group	*Classification*	*Basis of Classification*
Drugstores	Large, medium, and small	Annual turnover
Hospitals	Large, medium, and small	Number of beds
Doctors	Large, medium, and small	Number of patients attended

Then the desired level of penetration for each subgroup should be specified (e.g., penetrate 90 percent of the large, 75 percent of the medium, and 50 percent of the small drugstores). These percentages can be used for examining the effectiveness of an alternative channel.

An advanced analysis is possible, however, by building a penetration model. The basis of the model is that increments in penetration for equal periods are proportional to the remaining distance to the aimed penetration. The increments in penetration in a period t will be: $t = rp(1 - r)t - 1$, where p = targeted or aimed penetration and r = penetration ratio. This ratio signifies how rapidly the cumulative penetration approaches aimed penetration. For example, if aimed penetration is

80 percent and if $r = 0.3$, then first-year penetration is $80 \times 0.3 = 24$ percent. Next year, the increment in penetration will be $80 \times 0.3 \times 0.7 = 16.8$ percent. Hence, cumulative penetration at the end of the second year will be $24 + 16.8 = 40.8$. The value of p for each subgroup is a matter of policy decision on the part of the company. The value of r depends on the period during which aimed penetration is to be achieved and on sales efforts in terms of the number of medical representatives/salespeople and their call pattern for each subgroup. For the existing channel (selling through the wholesalers), the value of r can be determined from past records. For the alternate channel (direct distribution), the approximate value of r can be computed in one of two ways:

1. Company executives should know how many salespeople would be kept on the rolls if the alternate channel were used. The executives can also estimate the average number of calls a day a salesperson can make and hence the average number of customers in a subgroup he or she can contact. With this information, the value of r can be determined as follows:

$$\frac{\text{Number of customers in a subgroup contacted under existing channel}}{\text{Number of customers in a subgroup that would be contacted in alternate channel}} = \frac{\text{Value of } r \text{ for existing channel}}{\text{Value of } r \text{ for alternate channel}}$$

2. A second approach may be to find out (or estimate) the penetration that would be possible after one year if the alternate channel is used, then to substitute this in the penetration equation to find r when p and t are known.

The penetration model makes it easier to predict the exact coverage in each subgroup of customers over a planning period (say, five years hence). The marketing strategist should determine the ultimate desired penetration p and the time period in which it is to be achieved. Then the model would be able to predict which channel would take the penetration closer to the objective.

Customer Service. The level of customer service differs from customer to customer for each business. Generally speaking, the sales department, with feedback from the field force, should be able to designate the various services that the company should offer to different consumer segments. If this is not feasible, a sample survey may be planned to find out which services customers expect and which services are currently being offered by competitors. This information can be used to develop a viable service package. Then the capability and willingness of each channel alternative to provide these services may be matched to single out the most desirable channel. This can be done intuitively. A more scientific approach would be to list and assign weights to each type of service, then rate different channels according to their ability to handle these services. Cumulative scores can be used for the service ranking of channel alternatives. Conjoint measurement can be used to determine which services are most important to a particular segment of customers.

Communication and Control. **Control** may be defined as the process of taking steps to bring actual results and desired results closer together. **Communication** refers to the information flow between the company and its customers. To evaluate alternate channels on these two criteria, communication and control objectives should be defined. With reference to communication, for example, information may be desired on the activities of competitors, new products from competitors, the special promotional efforts of competitors, the attitudes of customers toward the company's and toward competitors' services, and the reasons for success of a particular product line of the company. Each channel alternative may then be evaluated in terms of its willingness, capabilities, and interest in providing the required information. In the case of wholesalers, the communication perspective may also depend on the terms of the contract. But the mere fact that they are legally bound by a contract may not motivate wholesalers to cooperate willingly. Finally, the information should be judged for accuracy, timeliness, and relevance.

Channel Modification

Environmental shifts, internal or external, may require a company to modify existing channel arrangements. A shift in trade practice, for instance, may render distribution through a manufacturer's representative obsolete. Similarly, technological changes in product design may require frequent service calls on customers that wholesalers may not be able to make, thus leading the company to opt for direct distribution.

To illustrate the point, consider jewelry distribution. For centuries, jewelry was distributed through jewelry shops that relied on uniqueness, craftsmanship, and mystique to reap fat margins on very small volumes. Traditionally, big retailers shunned jewelry as a highly specialized, slow-moving business that tied up too much money in inventory. But this attitude has changed in the last few years. For example, between 1978 and 1982, jewelry stores' share of the jewelry market declined from 65 percent to less than 50 percent. On the other hand, relying on hefty advertising and deep discounting, mass merchandisers (e.g., J.C. Penney, Sears, Montgomery Ward, Target, and others) have been making fast inroads into the jewelry business. For example, in 1983 J.C. Penney became the fourth-largest retail jewelry merchant in the United States behind Zale, Gordon Jewelry, and Best Products, the catalog showroom chain. Such a shift in trade practice requires that jewelry manufacturers modify their distribution arrangements.[23]

Similarly, as computer makers try to reach ever-broadening audiences with lower-priced machines, they need new distribution channels. Many of them, IBM and Apple, for example, have turned to retail stores. In the 1970s, people would have laughed at the idea of selling computers over the counter; now it is a preferred way of doing business. The tantalizing opportunity to sell computers to consumers has also given birth to specialty chains specializing in computer and related items.

Ben & Jerry's Homemade Inc. had to change their distribution arrangements for a different reason. Dreyer's Grand Ice Cream controlled 70 percent of its distribution, and the relationship was regarded as a cornerstone of Ben & Jerry's success.

Then, Dreyer made an unwanted takeover offer which Ben & Jerry's resented. The company decided to end the relationship with Dreyer and forged a new alliance with Diage PLC's Haagen-Dazs, until now regarded as an arch competitor, to deliver its products.[24]

Generally speaking, a new company in the market starts distribution through intermediaries. This is necessary because, during the initial period, technical and manufacturing problems are big enough to keep management busy. Besides, at this stage, the company has neither the insight nor the capabilities needed to deal successfully with the vagaries of the market. Therefore, intermediaries are used. With their knowledge of the market, they play an important role in establishing a demand for a company's product. But once the company establishes a foothold in the market, it may discover that it does not have the control of distribution it needs to make further headway. At this time, channel modification becomes necessary.

Managerial astuteness requires that the company do a thorough study before deciding to change existing channel arrangements. Taking a few halfhearted measures could create insurmountable problems resulting in loose control and poor communication. Further, the intermediaries affected should be duly taken into confidence about a company's plans and compensated for any breach of terms. Any modification of channels should match the perspectives of the total marketing strategy. This means that the effect of a modified plan on other ingredients of the marketing mix (such as product, price, and promotion) should be considered. The managers of different departments (as well as the customers) should be informed so that the change does not come as a surprise. In other words, care needs to be taken to ensure that a modification in channel arrangements does not cause any distortion in the overall distribution system.

The point may be illustrated with reference to Caterpillar.[25] A decade ago, many observers predicted Caterpillar's demise. Yet today the company's overall share of the world market for construction and mining equipment is the highest in its history. And the biggest reason for the turnaround, has been the company's system of distribution and product support and the close customer relationships it fosters. The backbone of that system is Caterpillar's 186 independent dealers around the world. They have played a central role in helping the company build close relationships with customers and gain insights into how it can improve products and services. The company's success may be attributed to several factors. For one thing, the company stands by its dealers in goods times and in bad. In addition, it gives them extraordinary support, helps ensure that the dealerships are well run, and emphasizes full and honest two-way communication. Finally, it stresses the emotional ties that have developed between the company and its dealers over time.

CHANNEL-CONTROL STRATEGY

Channel arrangements traditionally consisted of loosely aligned manufacturers, wholesalers, and retailers, all of whom were trying to serve their own ends regardless of what went on elsewhere in the channel structure. In such arrangements,

channel control was generally missing. Each member of the channel negotiated aggressively with others and performed a conventionally defined set of marketing functions.

Importance of Channel Control

For a variety of reasons, control is a necessary ingredient in running a successful system. Having control is likely to have a positive impact on profits because inefficiencies are caught and corrected in time. This is evidenced by the success of voluntary and cooperative chains, corporate chains, franchise alignments, manufacturers' dealer organizations, and sales branches and offices. Control also helps to realize cost effectiveness vis-à-vis experience curves. For example, centralized organization of warehousing, data processing, and other facilities provide scale efficiencies. Through a planned perspective of the total system, effort is directed to achieving common goals in an integrated fashion.

Channel Controller

The focus of channel control may be on any member of a channel system: the manufacturer, wholesaler, or retailer. Unfortunately, there is no established theory to indicate whether any one of them makes a better channel controller than the others. For example, one appliance retailer in Philadelphia with a 10 percent market share, Silo Incorporated, served as the channel controller there. This firm had no special relationship with any manufacturer, but if a supplier's line did not do well, Silo immediately contacted the supplier to ask that something be done about it. Wal-Mart (in addition to KMart and Target) can be expected to be the channel controller for a variety of products. Among manufacturers, Kraft ought to be the channel controller for refrigerated goods in supermarkets. Likewise, Procter & Gamble is a channel controller for detergents and related items. Ethan Allen decided to control the distribution channels for its line of Early American furniture by establishing a network of 200 dealer outlets. Sherwin-Williams decided to take over channel control to guide its own destiny because traditional channels were not showing enough aggressiveness. The company established its own chain of 2,000 retail outlets.

These examples underscore the importance of someone taking over channel leadership in order to establish control. Conventionally, market leadership and the size of a firm determine its suitability for channel control. Strategically, a firm should attempt to control the channel for a product if it can make a commitment to fulfill its leadership obligations and if such a move is likely to be economically beneficial in the long run for the entire channel system. For example, the thought of winning a contract to supply a mass retailer may lead a company to modify existing channel arrangements. After all, Toys "R" Us accounted for a fifth of the U.S. toy market in 1996. The Home Depot sold more home improvement products than all hardware stores combined, and the quarter of the underwear purchased by Americans came from Wal-Mart (an estimated 23 percent of the U.S. population shops in Wal-Mart on an average day).[26] Landing an account with one of these mass retailers can double or even triple a supplier's annual sales. However, rapid revenue growth is not always accompanied by a surge in profits. The strain of coping with high volumes and the service needs of powerful customers can put

tremendous pressure on suppliers' profit margins if they attempt to conduct business as usual. Some manufacturers that supply mass retailers even find that although their sales rise faster than those of other manufacturers, their earnings growth is slower.

Vertical Marketing Systems

Vertical marketing systems may be defined as:

> professionally managed and centrally programmed networks [that] are pre-engineered to achieve operating economies and maximum market impact. Stated alternatively, vertical marketing systems are rationalized and capital-intensive networks designed to achieve technological, managerial, and promotional economies through the integration, coordination, and synchronization of marketing flows from points of production to points of ultimate use.[27]

The vertical marketing system is an emerging trend in the American economy. It seems to be replacing all conventional marketing channels as the mainstay of distribution. As a matter of fact, according to one estimate, vertical marketing systems in the consumer-goods sector account for about 70 to 80 percent of the available market.[28] In brief, vertical marketing systems (sometimes also referred to as centrally coordinated systems) have emerged as the dominant ingredient in the competitive process and thus play a strategic role in the formulation of distribution strategy.

Vertical marketing systems may be classified into three types: corporate, administered, and contractual. Under the corporate vertical marketing system, successive stages of production and distribution are owned by a single entity. This is achieved through forward and backward integration. Sherwin-Williams owns and operates its 2,000 retail outlets in a corporate vertical marketing system (a case of forward integration). Other examples of such systems are Hart, Schaffner, and Marx (operating more than 275 stores), International Harvester, Goodyear, and Sohio. Not only a manufacturer but also a corporate vertical system might be owned and operated by a retailer (a case of backward integration). Sears, like many other large retailers, has financial interests in many of its suppliers' businesses. For example, about one-third of DeSoto (a furniture and home furnishings manufacturer) stock is owned by Sears. Finally, W. W. Grainger provides an example of a wholesaler-run vertical marketing system. This firm, an electrical distributor with 1998 sales of $900 million, has nine manufacturing facilities.

Another outstanding example of a vertical marketing system is provided by Gallo, the wine company.

> The [Gallo] brothers own Fairbanks Trucking company, one of the largest intrastate truckers in California. Its 200 semis and 500 trailers are constantly hauling wine out of Modesto and raw materials back in including . . . lime from Gallo's quarry east of Sacramento. Alone among wine producers, Gallo makes bottles—two million a day—and its Midcal Aluminum Co. spews out screw tops as fast as the bottles are filled. Most of the country's 1,300 or so wineries concentrate on production to the neglect of marketing. Gallo, by contrast, participates in every aspect of selling short of whispering in

the ear of each imbiber. The company owns its distributors in about a dozen markets and probably would buy many . . . more . . . if the laws in most states did not prohibit doing so.[29]

In an **administered vertical marketing system**, a dominant firm within the channel system, such as the manufacturer, wholesaler, or retailer, coordinates the flow of goods by virtue of its market power. For example, the firm may exert influence to achieve economies in transportation, order processing, warehousing, advertising, or merchandising. As can be expected, it is large organizations like Wal-Mart, Safeway, J.C. Penney, General Motors, Kraft, GE, Procter & Gamble, Lever Brothers, Nabisco, and General Foods that emerge as channel captains to guide their channel networks, while not actually owning them, to achieve economies and efficiencies.

In a **contractual vertical marketing system**, independent firms within the channel structure integrate their programs on a contractual basis to realize economies and market impact. Primarily, there are three types of contractual vertical marketing systems: wholesaler-sponsored voluntary groups, retailer-sponsored cooperative groups, and franchise systems. Independent Grocers Alliance (IGA) is an example of a wholesaler-sponsored voluntary group. At the initiative of the wholesaler, small grocery stores agree to form a chain to achieve economies with which to compete against corporate chains. The joining members agree to adhere to a variety of contractual terms, such as the use of a common name, to help realize economies on large order. Except for these terms, each store continues to operate independently. A retailer-sponsored cooperative group is essentially the same. Retailers form their own association (cooperative) to compete against corporate chains by undertaking wholesaler functions (and possibly even a limited amount of production); that is, they operate their own wholesale companies to serve member retailers. This type of contractual vertical marketing system is operated primarily, though not exclusively, in the food line. Associated Grocers Co-op and Certified Grocers are examples of retailer-sponsored food cooperative groups. Value-Rite, a group of 2,298 stores, is a drugstore cooperative.[30]

A **franchise system** is an arrangement whereby a firm licenses others to market a product or service using its trade name in a defined geographic area under specified terms and conditions. In 1994, there were more than 2,800 franchisers in the United States, twice as many as in 1984. Practically any business that can be taught to someone is being franchised. In 1995, sales of goods and services by all franchising companies (manufacturing, wholesaling, and retailing) exceeded $600 billion. Approximately one-third of all U.S. retail sales flow through franchise and company-owned units in franchise chains.

In addition to traditional franchising businesses (e.g., fast-food), banks are doing it, as are accountants, dating services, skin care centers, tub and tile refinishers, tutors, funeral homes, bookkeepers, dentists, nurses, bird seed shops, gift wrappers, wedding consultants, cookie bakers, popcorn poppers, beauty shops, baby-sitters, and suppliers of maid service, lawn care, and solar greenhouses.

The Commerce Department forecasts that by the year 2000 franchising will account for half of all retail sales. Four different types of franchise systems can be distinguished:

1. The manufacturer-retailer franchise is exemplified by franchised automobile dealers and franchised service stations.
2. The manufacturer-wholesaler franchise is exemplified by Coca-Cola and PepsiCo, who sell the soft drink syrups they manufacture to franchised wholesalers who, in turn, bottle and distribute soft drinks to retailers.
3. The wholesaler-retailer franchise is exemplified by Rexall Drug Stores, Sentry Drug Centers, and CompUSA.
4. The service sponsor-retailer franchise is exemplified by Avis, Hertz, and National in the car rental business; McDonald's, Chicken Delight, Kentucky Fried Chicken, and Taco Bell in the prepared foods industry; Comfort Inn and Holiday Inn in the lodging and food industry; Midas and AAMCO in the auto repair business; and Kelly Girl and Manpower in the employment service business.

Vertical marketing systems help achieve economies that cannot be realized through the use of conventional marketing channels. In strategic terms, vertical marketing systems provide opportunities for building experience, thus allowing even small firms to derive the benefits of market power. If present trends are any indication, by the year 2000 vertical marketing systems should account for almost 90 percent of total retail sales. Considering their growing importance, conventional channels will need to adopt new distribution strategies to compete against vertical marketing systems. For example, they may

1. Develop programs to strengthen customers' competitive capabilities. This alternative involves manufacturers and wholesalers in such activities as sponsoring centralized accounting and management reporting services, formulating cooperative promotional programs, and cosigning shopping center leases.
2. Enter new markets. For example, building supply distributors have initiated cash-and-carry outlets. Steel warehouses have added glass and plastic product lines to their traditional product lines. Industrial distributors have initiated stockless buying plans and blanket order contracts so that they may compete effectively for customers who buy on a direct basis.
3. Effect economies of operation by developing management information systems. For example, some middlemen in conventional channels have installed the IBM IMPACT program to improve their control over inventory.
4. Determine through research the focus of power in the channel and urge the channel member designated to undertake a reorganization of marketing flows.[31]

Despite the growing trend toward vertical integration, it would be naive to consider it an unmixed blessing. Vertical integration has both pluses and minuses—more of the latter, according to one empirical study on the subject.[32] For example, vertical integration requires a huge commitment of resources: in mid-1981, Du Pont acquired Conoco in a $7.3 billion transaction. The strategy may not be worthwhile unless the company gains needed insurance as well as cost savings. As a matter of fact, some observers have blamed the U.S. automobile industry's woes, in part, on excessive vertical integration: "In deciding to

integrate backward because of apparent short-term rewards, managers often restrict their ability to strike out in innovative directions in the future."[33]

CONFLICT-MANAGEMENT STRATEGY

It is quite conceivable that the independent firms that constitute a channel of distribution (i.e., manufacturer, wholesaler, retailer) may sometimes find themselves in conflict with each other. The underlying causes of conflict are the divergent goals that different firms may pursue. If the goals of one firm are being challenged because of the strategies followed by another channel member, conflict is the natural outcome. Thus, channel conflict may be defined as a situation in which one channel member perceives another channel member or members to be engaged in behavior that is preventing or impeding it from achieving its goals.

Disagreement between channel members may arise from incompatible desires and needs. Weigand and Wasson give four examples of the kinds of conflict that may arise:

> A manufacturer promises an exclusive territory to a retailer in return for the retailer's "majority effort" to generate business in the area. Sales increase nicely, but the manufacturer believes it is due more to population growth in the area than to the effort of the store owner, who is spending too much time on the golf course.
>
> A fast-food franchiser promises "expert promotional assistance" to his retailers as partial explanation for the franchise fee. One of the retailers believes that the help he is getting is anything but expert and that the benefits do not correspond with what he was promised.
>
> Another franchiser agrees to furnish accounting services and financial analysis as a regular part of his service. The franchisee believes that the accountant is nothing more than a "glorified bookkeeper" and that the financial analysis consists of several pages of ratios that are incomprehensible.
>
> A third franchiser insists that his franchisees should maintain a minimum stock of certain items that are regularly promoted throughout the area. Arguments arise as to whether the franchiser's recommendations constitute a threat, while the franchisee is particularly concerned about protecting his trade name.[34]

The four strategic alternatives available for resolving conflicts between channel members are bargaining, boundary, interpenetration, and superorganizational strategies.[35] Under the **bargaining strategy**, one member of the channel takes the lead in activating the bargaining process by being willing to concede something, with the expectation that the other party will reciprocate. For example, a manufacturer may agree to provide interest-free loans for up to 90 days to a distributor if the distributor will carry twice the level of inventory that it previously did and will furnish warehousing for the purpose. Or a retailer may propose to continue to carry the television line of a manufacturer if the manufacturer will supply television sets under the retailer's own name (i.e., the retailer's private brand). The bargaining strategy works out only if both parties are willing to adopt the attitude of give-and-take and if bottom-line results for both are favorable enough to induce them to accept the terms of the bargain.

The **boundary strategy** handles the conflict through diplomacy; that is, by nominating the employee most familiar with the perspectives of the other party to take up the matter with his or her counterpart. For example, a manufacturer may nominate a veteran salesperson to communicate with the purchasing agent of the customer to see if some basis can be established to resolve the conflict. For example, North Face, the manufacturer of high-performance outdoor clothes, is expanding beyond the $5 billion specialty outdoor market to the broader $30-billion casual sportswear market. To implement the strategy, it plans to increase the number of stores selling North Face after 2001, from 1,500 specialty stores up to 4,000 retailers.[36]

This has upset the specialty stores since they fear that the expansion will undercut the brand, putting pressure on their margins. To resolve the conflict, the North Face salesperson may meet the specialty store buyers to talk over business in general. In between the talks, he or she may indicate in a subtle way that the company's decision to broaden the distribution would be mutually beneficial. In the end, the specialty stores will reap the benefits of the brand name popularity triggered by the mass distribution. Besides, the salesperson may be authorized to propose that his or her company will agree not to sell the top of the line to "new retailers," thus ensuring that it will continue to be available only through the specialty stores. In order for this strategy to succeed, it is necessary that the diplomat (the salesperson in the example) be fully briefed on the situation and provided leverage with which to negotiate.

The **interpenetration strategy** is directed toward resolving conflict through frequent informal interactions with the other party to gain a proper appreciation of each other's perspectives. One of the easiest ways to develop interaction is for one party to invite the other to join its trade association. For example, several years ago television dealers were concerned because they felt that the manufacturers of television sets did not understand their problems. To help correct the situation, the dealers invited the manufacturers to become members of the National Appliance and Radio-TV Dealers Association (NARDA). Currently, manufacturers take an active interest in NARDA conventions and seminars.

Finally, the focus of **superorganizational strategy** is to employ conciliation, mediation, and arbitration to resolve conflict. Essentially, a neutral third party is brought into the conflict to resolve the matter. **Conciliation** is an informal attempt by a third party to bring two conflicting organizations together and make them come to an agreement amicably. For example, an independent wholesaler may serve as a conciliator between a manufacturer and its customers. Under **mediation**, the third party plays a more active role. If the parties in conflict fail to come to an agreement, they may be willing to consider the procedural or substantive recommendations of the mediator.

Arbitration may also be applied to resolve channel conflict. Arbitration may be compulsory or voluntary. Under compulsory arbitration, the dispute must by law be submitted to a third party, the decision being final and binding on both conflicting parties. For example, the courts may arbitrate between two parties in dispute. Years ago, when automobile manufacturers and their dealers had problems

relative to distribution policies, the court arbitrated. Voluntary arbitration is a process whereby the parties in conflict submit their disputes for resolution to a third party on their own. For example, in 1955 the Federal Trade Commission arbitrated between television set manufacturers, distributors, and dealers by setting up 32 industry rules to protect the consumer and to reduce conflicts over distribution. The conflict areas involved were tie-in sales; price fixing; mass shipments used to clog outlets and foreclose competitors; discriminatory billing; and special rebates, bribes, refunds, and discounts.[37]

Of all the methods of resolving conflict, arbitration is the fastest.[36] In addition, under arbitration, secrecy is preserved and less expense is incurred. Inasmuch as industry experts serve as arbitrators, one can expect a fairer decision. Thus, as a matter of strategy, arbitration may be more desirable than other methods for managing conflict. Exhibit 16-5 lists different ways of managing channel conflict.

SUMMARY

Distribution strategies are concerned with the flow of goods and services from manufacturers to customers. The discussion in this chapter was conducted from the manufacturer's viewpoint. Six major distribution strategies were distinguished: channel-structure strategy, distribution-scope strategy, multiple-channel strategy, channel-modification strategy, channel-control strategy, and conflict-management strategy.

Channel-structure strategy determines whether the goods should be distributed directly from manufacturer to customer or indirectly through one or more intermediaries. Formulation of this strategy was discussed with reference to Bucklin's postponement-speculation theory. Distribution-scope strategy specifies whether exclusive, selective, or intensive distribution should be pursued. The question of simultaneously employing more than one channel was discussed under multiple-channel strategy. Channel-modification strategy involves evaluating current channels and making necessary changes in distribution perspectives to accommodate environmental shifts. Channel-control strategy focuses on vertical marketing systems to institute control. Finally, resolution of conflict among channel members was examined under conflict-management strategy.

The merits and drawbacks of each strategy were discussed. Examples from marketing literature were given to illustrate the practical applications of different strategies.

DISCUSSION QUESTIONS

1. What factors may a manufacturer consider to determine whether to distribute products directly to customers? Can automobiles be distributed directly to customers?
2. Is intensive distribution a prerequisite for gaining experience? Discuss.
3. What precautions are necessary to ensure that exclusive distribution is not liable to challenge as a restraint of trade?

4. What strategic factor makes the multiple-channel strategy a necessity for a multiproduct company?
5. What criteria may a food processor adopt to evaluate its channels of distribution?
6. What kinds of environmental shifts require a change in channel arrangements?
7. What reasons may be ascribed to the emergence of vertical marketing systems?
8. What strategies may conventional channels adopt to meet the threat of vertical marketing systems?
9. What are the underlying sources of conflict in distribution channel relations? Give examples.
10. What is the most appropriate strategy for resolving a channel conflict?

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APPENDIX | *Perspectives on Distribution Strategies*

I. Channel-Structure Strategy

Definition: Using perspectives of intermediaries in the flow of goods from manufacturers to customers. Distribution may be either direct (from manufacturer to retailer or from manufacturer to customer) or indirect (involving the use of one or more intermediaries, such as wholesalers or agents, to reach the customer).

Objective: To reach the optimal number of customers in a timely manner at the lowest possible cost while maintaining the desired degree of control.

Requirements: Comparison of direct versus indirect distribution on the basis of (a) cost, (b) product characteristics, (c) degree of control, and (d) other factors.

Costs: (a) Distribution costs. (b) Opportunity costs incurred because product not available. (c) Inventory holding and shipping costs.

Product Characteristics: (a) Replacement rate. (b) Gross margin. (c) Service requirements. (d) Search time.

Degree of Control: Greater when direct distribution used.

Other Factors: (a) Adaptability. (b) Technological changes (e.g., computer technology). (c) Social/cultural values.

Expected Results: (a) Direct distribution: (i) high marketing costs, (ii) large degree of control, (iii) informed customers, and (iv) strong image. (b) Indirect distribution: (i) lower marketing costs, (ii) less control, and (iii) reduced channel management responsibilities.

II. Distribution-Scope Strategy

Definition: Establishing the scope of distribution, that is, the target customers. Choices are exclusive distribution (one retailer is granted sole rights in serving a given area), intensive distribution (a product is made available at all possible retail outlets), and selective distribution (many but not all retail outlets in a given area distribute a product).

Objective: To serve chosen markets at a minimal cost while maintaining desired product image.

Requirements: Assessment of (a) customer buying habits, (b) gross margin/turnover rate, (c) capability of dealer to provide service, (d) capability of dealer to carry full product line, and (e) product styling.

Expected Results: (a) Exclusive distribution: (i) strong dealer loyalty, (ii) high degree of control, (iii) good forecasting capability, (iv) sales promotion assistance from manufacturer, (v) possible loss in sales volume, and (vi) possible antitrust violation. (b) Selective distribution: (i) extreme competition in marketplace, (ii) price discounting, and (iii) pressure from channel members to reduce number of outlets. (c) Intensive distribution: (i) low degree of control, (ii) higher sales volume, (iii) wide customer recognition, (iv) high turnover, and (v) price discounting.

III. Multiple-Channel Strategy

Definition: Employing two or more different channels for distribution of goods and services. Multiple-channel distribution is of two basic types: complementary (each channel handles a different noncompeting product or market segment) and competitive (two different and competing channels sell the same product).

Objective: To achieve optimal access to each individual market segment to increase business. Complementary channels are used to reach market segments otherwise left unserved; competitive channels are used with the hope of increasing sales.

Requirements: (a) Market segmentation. (b) Cost/benefit analysis. Use of complementary channels prompted by (i) geographic considerations, (ii) volume of business, (iii) need to distribute noncompeting items, and (iv) saturation of traditional distribution channels. Use of competitive channels can be a response to environmental changes.

Expected Results: (a) Different services, prices, and support provided to different segments. (b) Broader market base. (c) Increased sales. (d) Possible dealer resentment. (e) Control problems. (f) Possible over-extension. Over-extension can result in (i) decrease in quality/service and (ii) negative effects on long-run profitability.

IV. Channel-Modification Strategy

Definition: Introducing a change in the existing distribution arrangements on the basis of evaluation and critical review.

Objective: To maintain an optimal distribution system given a changing environment.

Requirements: (a) Evaluation of internal/external environmental shifts: (i) changes in consumer markets and buying habits, (ii) changes in the retail life cycle, (iii) changes in the manufacturer's financial strength, and (iv) changes in the product life cycle. (b) Continuous evaluation of existing channels. (c) Cost/benefit analysis. (d) Consideration of the effect of the modified channels on other aspects of the marketing mix. (e) Ability of management to adapt to modified plan.

Expected Results: (a) Maintenance of an optimal distribution system given environmental changes. (b) Disgruntled dealers and customers (in the short run).

V. Channel-Control Strategy

Definition: Takeover by a member of the channel structure in order to establish control of the channel and provide a centrally organized effort to achieve common goals.

Objectives: (a) To increase control. (b) To correct inefficiencies. (c) To realize cost-effectiveness through experience curves. (d) To gain efficiencies of scale.

Requirements: Commitment and resources to fulfill leadership obligations. Typically, though not always, the channel controller is a large firm with market leadership/influence.

Expected Results (Vertical Marketing System): (a) Increased control. (b) Professional management. (c) Central programming. (d) Achievement of operating economies. (e) Maximum market impact. (f) Increased profitability. (g) Elimination of inefficiencies.

VI. Conflict-Management Strategy

Definition: Resolving conflict among channel members.

Objective: To devise a solution acceptable to the conflicting members so that they will cooperate to make it work.

Requirements: Choice of a strategy for solving the conflict. (a) Bargaining: (i) both parties adopt give-and-take attitude and (ii) bottom line is favorable enough to

both parties to induce them to accept the terms of the bargain. (b) Boundary: (i) nomination of an employee to act as diplomat, (ii) diplomat is fully briefed on the situation and provided with leverages with which to negotiate, and (iii) both parties are willing to negotiate. (c) Interpenetration: (i) frequent formal interactions with the other party to develop an appreciation of each other's perspectives and (ii) willingness to interact to solve problems. (d) Superorganizational: A neutral third party is brought into the conflict to resolve the matter by means of (i) conciliation, (ii) mediation, or (iii) arbitration (compulsory or voluntary).

Expected Results: (a) Elimination of snags in the channel. (b) Results that are mutually beneficial to the parties involved. (c) Need for management time and effort. (d) Increased costs. (e) Costs incurred by both parties in the form of concessions.