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SATISFACTION THROUGH DISTRIBUTION

12.1 INTRODUCTION

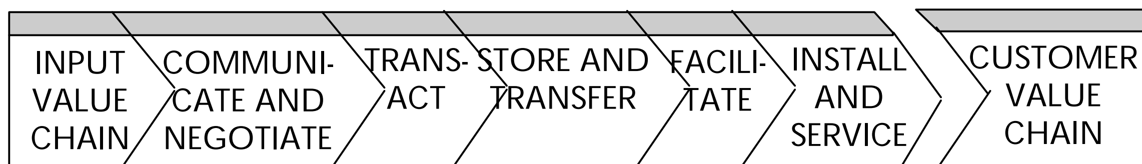
Most **producers** work with **marketing intermediaries** to bring their **products** or **services** to the market. Market channels are the marketing intermediaries involved in the process of making a product or service available for use or consumption to the ultimate user. Given some products to be marketed, several jobs must be done.

- This consists of arranging or bringing about changes in ownership by performance of the functions of exchange, buying and selling.

- There is the matter of availability of physical supply, which involves the functions of transportation and storage, and related activities such as physical handling, and control of inventories.
- There is the necessity of various facilitating or auxiliary functions, such as the collection and dissemination of marketing information, management of market risks, financing of marketing activities, and standardization and grading.

These **activities** can be an integral part of the firm's value chain or be made as a separate link in a system of related value chains. (**Exhibit 12-1**) shows the channel activities in the value chain.

Exhibit 12-1 : Channel Activities in the Value Chain



Channel design involves the decision of **where** and **how** each of these activities is to be done to best support the customer value strategy. **Four key** questions have to be answered :

- How many activities should be performed internally?
- How many different channels should be used?
- What density of channel coverage is needed?
- How much control should be exercised over resellers?

Different companies within the same industry will have different answers to those questions, depending on their objectives and the competitive advantages they try to pursue. In the 1970s, some companies emphasized low price as their operating strategy. Consequently, the ability to be competitive

over delivered costs, not product quality, was the key attribute which they required of their suppliers. Under these circumstances, the poor managerial skills of some dealers had subsequently damaged the product reputation on the marketing level.

For a long time, **distribution** has been managed to reduce costs and to avoid conflicts. For reasons of inertia, tradition, industry practice and an absence of feasible alternatives, management tended to stay with their existing channels. However, the new changing business environment is pushing firms to reassess the channels used to reach out to their target markets. Strategic **decisions** about **how to reach** markets are made in a larger context, beyond satisfying customer requirements and minimizing costs.

The search for a competitive distribution strategy is being propelled by the following forces :

- Increasingly assertive customers who look for collaborative relationships with a shrinking number of suppliers.
- The emergence of new technological capabilities provides a rich array of channel possibilities.
- Increasingly powerful intermediaries able to bargain for a greater share of value created.
- Increasingly strategic alliances require the reappraisal of the traditional channels.

The **challenge** is to find the **combinations** of channels that will best support the business strategy by balancing customer responsiveness with the minimum costs incurred - while developing cooperation among all links in the channel network. In order to meet the new challenge, companies have to reassess the channel structure.

12.2 CHANNEL STRUCTURE

Channel structure refers to the **number of levels** and the number and type of middlemen who will operate at each level.

A zero level channel (also called a direct-marketing channel) consists of a producer selling directly to the final customer. A one-level channel contains one selling intermediary, such as a retailer. A two-level channel contains two intermediaries, such as a wholesaler and a retailer.

Before making the **channel structure decision**, the producer must examine such factors as customer requirements, market coverage, market control and comparative costs of acquiring the required channel functions.

1. **Customer Requirements**

   The question the producer should ask is "who is the end-user of the market offering and what are the buying habits?"

   This leads to the question of market coverage, e.g. "what" type of outlet should carry the product line and how intense should distribution be? To answer these questions, the producer must consider such factors as price, sales turnover rate, installation and service requirements, seasonality and perishability, available markups, competitive products, and a customer awareness of the product together with its benefits.

   The usual rule states that frequently purchased items sold to widely dispersed markets, offering low gross margins, and requiring minimal adaptation at the time of purchase, are best sold via dealers or retail stores.

   Direct or vertically integrated distribution systems are most favored with products that are complex, highly differentiated, expensive, and difficult to sell.

2. **Market Coverage**

The next question is **how many middlemen** will be positioned at each channel level. A specialty manufacturer such as a can producer may choose to appoint only an exclusive handful of dealers. While this restricts market coverage it ensures more aggressive and informed selling and enhances the image and service.

Alternatively, an **intensive network** for consumer products may be set up to sell through almost every possible outlets in a geographic area. The middle road is selective distribution, using a subset of all the intermediaries willing to carry the product.

As **products mature** and gain wider acceptance, producers try to increase the density of market coverage. This added density creates serious conflicts with the original selected distributors who face more competing resellers, carrying the same product just as the product's advantages are dissipating.

3. **Market Control**

It should be clear that, in general, the producer's **control** of **channel functions** is inversely proportional to the number of channel levels. Products that are seasonal, perishable, complex, of a national brand, and subject to public scrutiny, require more control by the producer than other products.

Tight control comes with the price, because it certainly takes time to supervise and manage the intermediaries' selling, stocking, and service activities, and may require a great deal of investment if there is an ownership stake.

At one extreme of control is a "**market linkage**" where a loose coalition of autonomous intermediaries is kept in line by use of the price mechanism. These networks tend to be highly

fragmented, with the parties negotiating with each other at arm's length.

A better control is exercised with "**leadership linkages**" where the dominant firm in the channel calls the tune and coordinates the players. Those who support channel leadership by producer, argue that most middlemen respect the authority of the producer and want to be guided in their marketing behavior and channel conflict will be minimized when a successful producer leads and controls channel activities at the outlet of the original channel relationship.

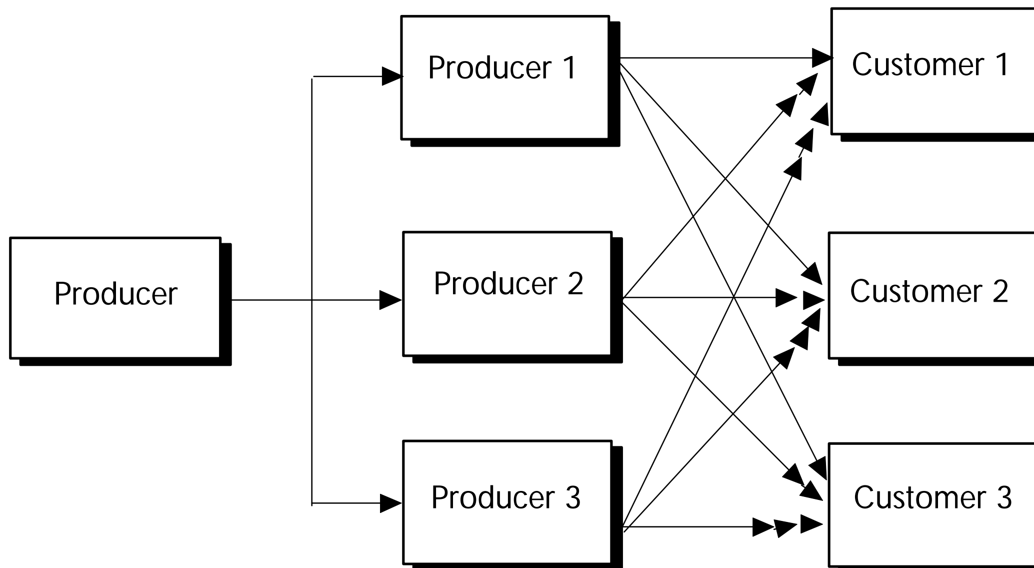
Ever tighter control is exercised with "**contractual linkages**"**.** This control comes from ownership - at which point it becomes a direct channel. The downside of tight control of intermediaries is a restriction on market coverage and the loss of flexibility that comes with contractual and equity ownership entanglements.

4. **Cost of Performing Channel Functions**

The producer should select the **channel structure** expected to deliver specified levels of market coverage, customer service, or channel control at the lowest possible cost. If the producer sells directly to the customer without the use of middlemen, the producer must maintain inventories, handle individual orders and assume all risks of collecting payments. The cost of performing these functions may or may not exceed the functional discounts or markups paid to middlemen for performing these functions.

As illustrated in (**Exhibit 12-2**), in direct supply, the customer is seeking a variety of products and the complexity of transactions will be very high. Involving an intermediary such as a supermarket to act as a middleman will reduce the number of transactions. (see **Exhibit 12-3**)

Exhibit 12-2 : Transaction Flows in a Direct Market Channel



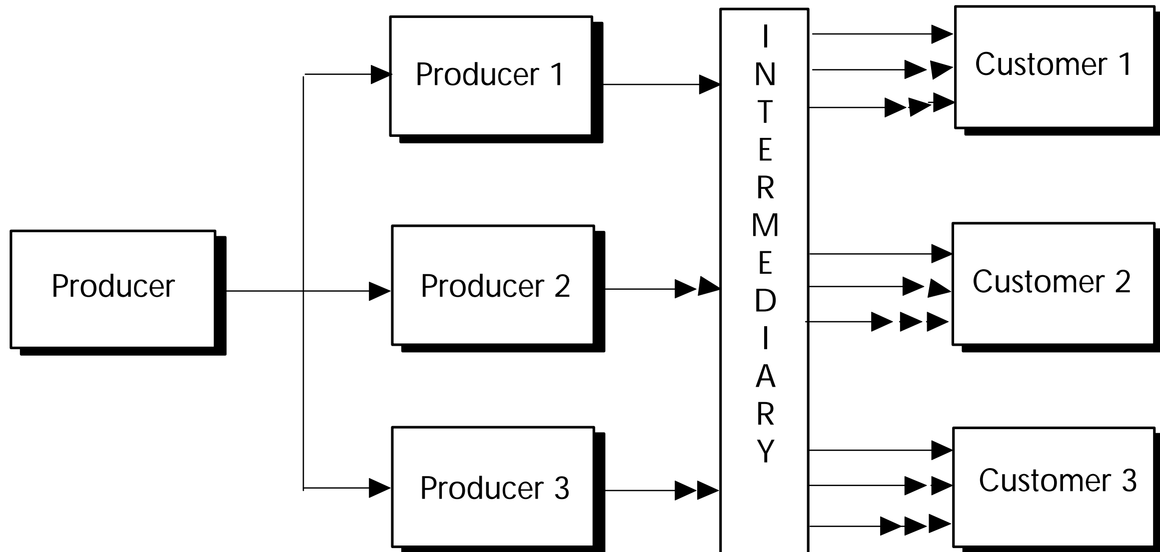
12.3 HYBRID MARKETING SYSTEM

In the 1990s', a **single distribution channel** will often no longer be sufficient to increase market coverage or to reach new customer segments. Additional channels, new communication methods and customized approaches create a hybrid marketing system. The elements of a hybrid marketing system are as follows:

- Direct sales
- Telemarketing
- Retail sales
- Distributors
- Dealers
- Valve-added Retailers
- National Account Management

- Buying groups

Exhibit 12-3 : Transaction Flows in an Indirect Market Channel



A well-managed **hybrid marketing system** enables a company to use the most cost effective channels and communication methods to meet the needs of specific customers and segments by using direct sales as well as distributors, including direct mail, telemarketing or retail sales.

The benefits of a hybrid marketing system are as follows :

1. It increases market coverage, reduces costs and provides more channels to reach the customer segments.

2. It enables a company to customize its marketing system to meet the needs of specific customers and segments.

3. It is a powerful weapon in an increasingly competitive and continually shifting battle for customers.

4. It helps build the marketing database on customers, prospects, products, marketing programs and methods.

5. It provides management with performance and productivity information on each marketing element.

Not only can one market **use multiple channels** of distribution, but customers can, and frequently do, order the same product through different channels. One week, the company may buy the product through a distributor, and the next week, directly from the factory on a rush order. When distribution channels compete with each other, it is called, "**channel conflict**". Channel conflict is a frequent occurrence. This channel conflict, along with the innumerable ways a product can typically reach the customer, makes segregation of costs between channels and markets a challenging task.

Indeed, a certain amount of **conflict** in a hybrid marketing system is not only inevitable, but also **healthy**. Managers should determine the amount and location of conflict. This is to establish clear and communicable boundaries and specific and enforceable guidelines spelling out which customers to serve and through which methods. Most companies observe some natural boundaries in the marketplace - areas defined by the interaction between buyer behavior and channel costs. Typically, companies target the largest and most profitable customers for some form of direct personal selling and serve smaller, less profitable accounts through another group distributors or dealers

One of the methods selected to handle the channel conflict is to **design boundaries** between customer segments. Boundary mechanisms that help achieve this goal are generally based on customer characteristics, geography and products.

1. **Customer Characteristics**

   Customers can be classified by size, order size, decision-making process or industry to design boundaries. For example, a computer company may specify that its value-added resellers (VARs) advantage should sell to small companies with less than $250 million in assets. For large companies, the manufacturer should sell directly through its own sales-force.

2. **Geographic Boundaries**

   Many companies serve large, urban markets through some form of direct sales and use distributors to cover less densely populated areas.

3. **Product Boundaries**

   Some companies sell high-end products through direct sales and use dealers or retail stores to sell low-end products.

A company with a **successful hybrid marketing** system will accomplish the following :

1. It recognizes that channels are not the basic building blocks of a marketing system; marketing tactics are.
2. It anticipates conflict is an inevitable part of the system. Therefore, conflict management and communication are required.
3. In designing boundaries between customer segments, it will strike a balance between too loose and too strict limits.
4. It requires re-designing of organizational structure and system to allow new channels to grow, and to minimize internal conflict.
5. It uses process re-engineering to improve the channel communication and process.
6. It requires a continuous improvement in quality and process.

12.4 CHANNEL RELATIONSHIP

A **first requirement** for any marketer seeking to ensure customer satisfaction is to acquire a detailed understanding of the relationships that exist with all the intermediaries.

Distribution channels have a major impact on **customer satisfaction**, because they can significantly affect the efficiency in the delivery of the products to the market. The principal challenge is **learning how** to deal with the dual nature of these relationships: at one level, distributors and other agents are a channel to sell through to the ultimate customers (or sometimes to another level in the distribution chain on the ways to customer); at the same time, they behave in many ways like customers to sell to, requiring similar commitment of resources and attention.

In today's **complex selling environment**, companies are increasingly complementing, and supplementing - building partnerships - essential to improve the channel performance to satisfy customer needs. Successful partnership can be expected to yield the following results:

1. Coordinated performance in the marketplace, with satisfied end users who are loyal to both the manufacturer and the distributor.
2. A better communication from both parties to understand the customer needs.
3. A better chance to reduce the errors, delays or defects and a consequent lower operation costs.
4. Motivation for superior effort and performance from both parties.
5. A complementary and supplementing actions to win the sales.

The following partnership experiences are useful to set up the relationship programs :

- **DuPont** has established a distributor marketing steering committee, consisting of 35 divisional distributor marketing managers, to discuss common distribution problems, share market information, and ponder changing distributor requirements. Committee meetings often include presentations by market research analysts, consultants, and the distribution

marketing managers of non-competing companies

- **Square D** keeps in touch with its distributors' and customers' need through its "Counter Days" program; where Square D's field salespeople spend a day at the distributor's location "working the counter" - answering customer questions and demonstrating its products.

- **Dayco Corporation** uses newsletters to inform distributors about new products and applications, personnel changes, distribution news, and human interest stories. It also uses an intriguing program, called "After market 2000" to accomplish long-term relationships. Each year, Dayco sponsors a week-long retreat for 20 young distributor executives and 20 young Dayco executives that features notable speakers, seniors on future economic and market trends, and most important, plenty of time to interact.

In a perspective review of **techniques** for developing distributor partnerships, **James Nauvis** and **James Anderson** suggested a number of approaches which can be summarized as follows:[11]

1. Understanding Distributor Needs
    - counter days
    - learn from total experience within the company
    - conduct market research and share information
    - establish a distributor council
2. Building Working Partnerships
    - study dealer operations

[11] "Turn Your Industrial Distributors Into Partners", Harvard Business Review, 1986, March/April 64, pp. 66-71.

- devise a formal distributor marketing plan
- obtain dealer inputs for own plan
- keep distributors informed of competitive situation
- offer skill enhancement training

3. Developing Sound Communications

- maintain high quality field sales and internal sales office operations
- top-executive-to-top-executive contact
- create knowledge of the company in depth within distributor firms
- use full range of sales support tools, e.g. newsletters, video, brochures, point-of-sale

4. Signaling Commitment

- be selective in use of distributors
- pass on end user inquiries to distributors
- install distributor cost reduction programs
- communicate long-term plans and objectives
- the credit department is not there to say 'no'

12.5 CHANNEL DESIGN AND STRATEGY

The reassessment of a **channel configuration** begins with the recognition that a channel exists to **support** the **delivery** of customer value. The necessary steps to design an effective channel are as follows:

1. Analyze the current channel situation - competitive position, key trends and customer valve.

2. Obtain customer value analysis about the ability of channel alternatives to meet their needs.

3. Compare the relative costs and quality of channel alternatives.

4. Test alternatives for strategic fit and feasibility.

5. Design and implement programs for gaining maximum advantage while minimizing conflicts with intermediaries.

The traditional view on the **selection** of the most appropriate **distribution** channel was centered on the delivery of products or services basing it more on the issue of **minimum cost**. This view of channel selection, however, ignores the other vital aspect in the transaction process, such as :

- Assessing customer needs.
- Validating a fit between customer needs and suitability of the specific product offering.
- Provision of information to assist the customer to reach the best decision.
- Closing the sale and delivering post-purchase service.

In order to **satisfy customer needs** at minimum costs during the transaction process, one has to weigh the costs involved in managing the distribution channel.

Before setting up a **new distribution strategy**, we need to understand the distribution costs, as well as the customers' needs. It involves the following steps:

- Classifying customers into group.

- Assessing customer needs.
- Collecting cost data.
- Selecting cost drivers.
- Applying and analyzing costs.
- Weighing the strategic options.
- Making a new strategy recommendation.

The customers can be segregated into major groups representing different buying characteristics, end users, service requirements, packaging needs, sales volumes, product mix etc. The customer groups can be classified as distributors, dealers, buying groups or special accounts.

The **delivery requirements** will configure the distribution system. Customer value surveys are critical for effectively determining the delivery requirements. The buying criteria (distribution attributes) will be assessed by the customers according to importance and ranking. Some of the buying criteria may be as follows:

- Order accuracy
- Delivery time
- Delivery reliability
- Ease of order

After the delivery requirements have been identified in each market, it is important to **identify** the **distribution cost** on each transaction process. The distribution cost will be affected by the following factors :

- Number of distribution channels
- Number of steps in the distribution system

- Variety of items sold
- Customer diversity

In order to impute costs to activities, an **Activity-Based Costing** (ABC) system should be set up. ABC assigns all resources such as direct labor, depreciation, utilities, rent, freight and information systems-changes to each distribution channel. Distribution costs always vary by account. It costs more to ship cross-country than cross-town. Customers may require small deliveries or full truck-load shipments. One customer may negotiate drop shipments (delivered directly to customers) while others receive all goods at their warehouses. Using activity measures, ABC assigned marketing, discounts, sales force, shipping, and customer service costs to its respective customers.

With the activity-based costing information, a firm may expand **telemarketing**, eliminate back orders, raise its minimum order quantities, and increase its use of wholesalers. Telemarketing cuts sale expenses and allows the firm to reach new customers outside its traditional sales area, raising order quantities and using wholesalers slash distribution activities. Small orders can be handled by wholesaler who consolidate the orders, stock the products and invoice the customers.

Some channels of distribution are much less **expensive** than others. Knowledge of these costs can help a company re-orient its distribution strategy. The company may find that selling through wholesalers is too expensive, or that direct customer are not worthwhile because they order too many low-profit units.

Consequently, much more important than channel selection based on minimizing distribution costs is the **selection** and **management** of channels to ensure that participating intermediaries share a mutual goal with the supplier desiring to maximize customer value. Based on the activity-based costing information and the delivery requirements of the customers, the supplier can work together with the intermediaries to set up the quality improvement plans to improve the performance of the distribution process; such as

installing electronic-data-interchange (EDS) and increasing the discounts on multiple-unit orders.

12.6 THE ROLE OF LOGISTICS

Logistics can be a source of competitive advantage for a firm just like a good product, promotion, and price strategy. Distribution can be used as the primary reason why the target market will purchase, and distribution can be designed as a unique offering not duplicated by competition.

In 1900, 3M surveyed 18,000 European customers in 16 countries. Respondents agreed that on-time delivery, short lead times, product delivered in good condition, and effective handling of problems were important to a firm attempting to increase customer satisfaction and sales. Today, in an era of shrinking product life cycles, proliferating product lines, shifting distribution channels, changing technology, mastery of logistics management have become essential ingredients of competitive success. Companies that view logistics as an offensive marketing tool will likely make logistics an **integral part** of their business strategy.

12.6.1 Integrated Logistics Management Concept

During the past 30 years, logistics has emerged as a separate and dynamic discipline. Many major corporations have acknowledged the importance of logistics by placing responsibility for this function at the vice presidential level. Basically, the integrated logistics management concept refers to administering the various activities as an integrated system. In firms that have not adopted a systems integrative approach, logistics is a fragmented and often uncoordinated set of activities spread throughout various organizational functions with each individual function having its own budget and set of priorities and measurements. A number of firms, including Herman Miller, Quaker Oats, and Whirlpool Corporation, have found that total distribution costs can be reduced by integrating such distribution related activities

as customer service, transportation, warehousing, inventory management, order processing and information systems, and production planning and purchasing. Without this integrated approach, inventory tends to build up at the following critical business interfaces:

- Supplier-purchasing
- Purchasing-production
- Production-marketing
- Marketing-distribution
- Distribution-intermediary (wholesaler and/or retailer)
- Intermediary-consumer/user

In addition to improving the flow of inventory, integration improves transport asset utilization and warehouse asset utilization, and eliminates the duplication of departmental efforts. For example, rather than having the purchasing department negotiate with inbound carriers and the distribution department negotiate with outbound carriers, one organization can negotiate for both inbound and outbound transportation and plan the shipments to offset high-volume inbound shipments with high-volume outbound shipments to the same geographic areas. The central coordination of the various logistics activities forces cost trade-off to be made between and among customer service levels, tranportation, warehousing, inventory management, order processing, and production planning and/or purchasing.

12.6.2 Logistics and the Marketing Function

How a company allocates its resources to the components of the coordination of the various logistics activities forces cost trade-off to be made between and among customer service levels, transportation, warehousing, inventory management, order processing, and production

planning and/or marketing mix will determine a company's market share and profitability. Management can improve a firm's competitive position by spending more dollars on the marketing mix, by allocating resources more effectively and efficiently to the individual components of the marketing mix, and/or by making changes within a single component that will increase effectiveness and/or efficiency. Logistics adds time and place utility to a product and is seen in the front-line of providing customer service.

Manufactured products possess some value or utility because an assembled item is worth more than its unassembled components or raw materials. A completed automobile, for example, is more valuable to a consumer than its unassembled parts. The value, or utility, of making materials available in a completed state is called form utility. To the consumer, however, the product not only must have form utility, but it also must be in the right place, at the right time, and be available to purchase. The value added to products beyond that added by manufacturing is called place, time, and possession utility. The logistics activity provides place and time utility, while marketing provides possession utility.

Management is quite concerned with the value-added by logistics, because improvements in place and time utility are ultimately reflected in the firm's profits. Place utility is the value created or added to a product by making it available for purchase or consumption in the right place. Logistics is directly responsible for adding place utility to products as it efficiently moves raw materials, in-process inventory, and finished goods from point-of-origin to point-of-consumption. Time utility is the value created by making something available at the right time. Products are not as valuable to customers if they are not available precisely when they are needed. For example, a food processing company must have raw materials (food items), packaging materials, and other items available before the production process begins or before existing supplies run out. Failure to receive these items at the proper

time can cause costly production shut-downs and place the firm in a disadvantageous competitive position.

Marketing adds the possession utility to a product, which is the value added to a product by allowing the customer to take ownership of the item. Possession utility is not the result of logistics, but the offering of credit, quantity discounts, and delayed payments which enable the customer to assume possession of the product. The logistics and marketing processes culminate in possession utility.

In fact, logistics and marketing are very much aiming at the same target: providing total customer satisfaction. Customer service acts as the binding and unifying force for all of the logistics management activities. Customer satisfaction occurs if the firm's overall marketing effort is successful. Each element of a firm's logistics system can affect whether a customer receives the right product at the right place in the right condition for the right cost at the right time. Thus customer service involves successful implementation of the integrated logistics management concept in order to provide the necessary level of customer satisfaction at the lowest possible total cost. Logistics management activities include:

- **Customer Service**

  This is the most important part of what is delivered to customers: (1) it integrates all logistics management activities, (2) it has a large impact on customer satisfaction outcomes, and (3) it requires a customer-oriented philosophy which integrates and manages all of the elements of the customer interface within a predetermined cost-service mix.

- **Order Processing**

  The order processing may be compared to the human body's central nervous system, triggering the distribution process and

directing the actions taken in satisfying demand. Order processing includes operational elements, communication elements, and credit and collection elements.

- **Distribution Communications**

  Communication and information flows are vital to effective logistics management. Communication exists (1) between the firm, its customers and suppliers, (2) between the individual functions within the firm, (3) between logistics related activities, and (4) between the components of each logistics activity.

- **Inventory Control**

  This is a financially critical area. Stocks ties up capital in raw materials, parts and finished goods. On the other hand, stock also defines the customer service level and manufacturing capacity utilization. There will be a trade-off between service, capacity utilization and costs.

- **Demand Forecasting**

  This can be described as the determination of type, amount and location of product and customer service required at some point in the future. It allows better resource planning and is seen in many industries as an art rather than science. Computer modeling, trends analysis, sales force estimates etc. can help to increase forecasting accuracy.

- **Traffic and Transportation**

  This is managing the movement of products and is often the largest component of any logistics spent. It includes selecting the methods of shipment, routing, and regulatory compliance.

- **Warehousing and Storage**

  These are the activities that manage the space needed to hold or maintain inventory, which includes selection and acquisition of warehouse space, warehouse layout and design, safety and maintenance, as well as security and personnel.

- **Plant and Warehouse Site Selection**

  The facility site selection can have an enormous impact on logistics costs and customer service levels. Decisions should be based on geographic market assessment and cost-benefit analyses.

- **Material Handling**

  This is concerned with the management of every aspect of the flow of raw materials, in-process inventory and finished goods within a plant or warehouse. The basic objectives are to minimize handling, travel distance and goods in process to avoid bottlenecks while also maximizing safety and security.

  This is the acquisition of goods and services to ensure the operating effectiveness of the firms manufacturing and logistics processes. It covers requirements specification, price planning and negotiation, supplier selection, and supplier management.

- **Parts and Service Support**

  This includes all activities associated with the repair and servicing of products, supply of spare and replacement parts, and planning service support levels. This area is an increasingly important part of the total marketing package.

- **Packaging**

  Packaging performs marketing and logistics roles. It acts as product protection and as storage enabler (bar coding).

  This is concerned with waste material as a by-product of any manufacturing and logistics process and includes reprocessing, recycling, safe disposal, and regulatory compliance.

- **Return Goods Handling**

  Also referred to as "reverse logistics". For many different reasons channel members and customers may return products, and few logistics systems are set-up to cope with this, which in some cases cost up to 9 times the amount needed to ship it to the customer. Return goods handling is becoming more important as customers become more sophisticated and demanding and channel members become more powerful.

Logistics plays an important role in a firm's competitive strategy. It helps establishing positional advantages at the lowest delivered cost, thus logistics activities can significantly affect perceived customer service and value. Only by linking all logistics activities directly to the organization's strategic plan can logistics managers work effectively to support their organizations' strategy for achieving competitive advantage.