

Chapter II

DISTRIBUTION MANAGEMENT AND CHANNEL PRACTICES- AN OVERVIEW

The researcher has briefly explained the study concepts in this chapter. The chapter is organized in the following manner:

- i) A brief introduction about distribution management which is the root for this study,
- ii) A detailed discussion of the functions of the channel management and which is the core concept of this study, and
- iii) A detail explanation about the factors influencing the channel conflict and channel cooperation, which are the important for the study because its role in distribution management.

2.1 DISTRIBUTION MANAGEMENT

James R. Stock and Douglas M. Lambert (1987) define the Physical distribution is the movement of material from the point of production (manufacturer or vendor) to the point of consumption (consumer/customer). It is identified as the sub-function of supply which deals with the handling and processing of material from acquisition to delivery to the ultimate consumer -or elimination from the system. This sub-function includes the capability to identify, classify, receive, document, store, secure, maintain in storage, care and preserve, select, pack, package, ship, control in transit, and dispose of material¹.

Distribution channels have been defined in various ways, channels can be "the paths goods and title to these goods follow from producer to

consumer," or, "structures through which goods and services move from the producer to the consumer" (Louis Kreisberg and Louis W. Stern 1969)².

Distribution is one of the key variables in the marketing mix. Distribution channel management thus involves making sure that the distribution system supports the other variables of the marketing mix. For example, money spent on advertising may be wasted if the product is not widely available in local stores.

Frederick E. Webster, Jr (1992) have defined distribution as it is a combination of channel management and physical distribution management. Channel management concerns the entire process of setting up and operating the distribution network. Physical distribution management focuses more narrowly on providing products when and where they are needed³.

The role of distribution channel management has gained wide-spread attention in both manufacturing and service organizations over the past twenty years. Faced with falling profit margins in an increasingly competitive environment, organizations looked to the distribution channel function as a principal source for reducing costs and raising return on their investment.

Today distribution channels are still looked upon as a major source of potential cost reduction. However as organizations is realizing that their ability to compete is highly dependent upon providing quality customer service, distribution channels have reached a new level of significance. Distribution channel management is a prime contributor to customer service through its impact upon corporate image, product availability, and price competitiveness.

Distribution builds stable competitive advantages, since marketing channels are of long-range planning and implementation, and to build them needs a consistent structure and due also to the fact that they are focused on people and relationships (Rosenbloom, B 1999)⁴.

The most common form of distribution channel is one in which the manufacturer of a product or service goes to market via channel members which are independent entities (Stem and El-Ansary 1993)⁵.

2.2 CHANNEL MANGAGEMENT

(Rosenbloom 1999a) defines distribution channels as simply as the external contractual organization which firms operate to achieve their distribution objectives. Distribution channels all convey the notion of the route, path, or conduit through which goods, products or things of value flow as they move from the producer to the ultimate user of the product. As products become less differentiated and more commodity-like, the competition among firms is rapidly moving away from products toward attaining efficiencies in distribution⁶.

For most service, consumer, and industrial firms, the distribution channel, or inter-organizational network of institutions-comprised of agents, wholesalers, distributors, and retailers-plays a significant role in the flow of goods from producers to consumers. Because they depend on channel members to resell their products and perform a variety of distribution tasks, producers are increasingly concerned about the level of performance of these institutions. The growth in electronic channels has made both the sales managers' and the channel managers' jobs more complex. .(Stem, E1-Ansary and Coughlan 1996; Michman and Silbey 1980)⁷.

Distribution channels can be viewed as social systems influenced by behavioral dynamics (such as conflict) associated with all social systems (Stem and Brown1969).

Stern, L. W., El-Ansary, A. I. and Coughlan, A. T. (1996) distinguishes the channel members⁸. They are,

1. The producers -----Develops, produces, and markets the product
2. The wholesalers -----Interact between producer and distributor/dealer
3. Distributor/Dealer -----Interact between wholesaler and retailer
4. The retailers -----Interact between distributor/dealer and customer
5. Consumers -----The ultimate user

2.2.1 Types of Distribution Channel Format Practices

Types of channel formats vary based on the channel requirements. Stern, L. W., El-Ansary, A. I. and Coughlan, A. T., Erin Anderson., (1996) suggest the types of distribution channel formats.

I- Manufacturers-Based Channel Formats

- Manufacturer Direct
- Manufacturer-Owned Full-Service Whole Saler-Distributor
- Company Store-Manufacturer Outlet
- License
- Consignment-Locker Stock
- Broker

II- Retailer Based Channel Formats

- Franchise
- Dealer Direct
- Buying club
- Warehouse Club-Wholesale Club
- Mail Order-Costing
- Food Retailer
- Department Store
- Mass-Merchandiser
- Specialty Store
- Specialty Discounter- Category Killer
- Convenience Store
- Hypermarket

III-Service-Provider-Based Channel Formats

- Contract Warehousing
- Sub processor
- Cross Docking
- Integration of truck and rail (Inter-modal)
- Roller Freight

- Stack Train and Road Railer
- Scheduled Train
- Out sourcing
- Direct Mailer
- Bartering
- Value-Added Reseller
- Influencer-Specifier
- Financial Service Provider

IV- Other Channel Formats

- Door-to-Door Formats
- Individual On-site
- Route
- Home Party
- Multilevel Marketing
- Service Merchandising-Rack Jobbing
- Buyer- Initiated Formats
- Co-operative Stores
- Dealer Owned Co-op
- Buying Group

- Point-of-Consumption Merchandising Formats
- Vendor-Koisk
- Pay-Per Serving Pont of Dispensing
- Computer Access Information

V. Third Party Influencer Formats

- Charity
- Company Sponsored Program
- Premium and Gift Market
- Product Promotion Mailing with Normal Correspondence
- Customer List Cross-Selling
- VI. Catalog and Technology-Aided Formats
- Specialty Catalog
- Business-to-Business Catalog
- Television Home Shopping and Satellite Networks
- Interactive Merchandising
- Third-Party Catalog service
- Trade Show
- Database Marketing

2.2.2 Channel Members Value Services

Each member adds value to the promotion, the transaction, or the services associated with the purchase:

- _ Accounting services
- _ Advertising planning assistance
- _ Catalog services
- _ Co-op advertising programs
- _ Consumer advertising
- _ Data processing programs and systems
- _ Dealer shows and events
- _ Drop-ship programs
- _ Employee training
- _ Financing
- _ Forms and printing assistance
- _ Insurance programs
- _ Inventory control systems
- _ Management consultation services
- _ Merchandising assistance
- _ Ordering and processing systems
- _ Point-of-sale identification

_ Private-label merchandise

_ Store planning and layout

2.2.3 Roles of Channel Intermediaries

Channel objectives must be related to the broader marketing mix. It is aware of the economic and social factors which are crucial in managing the organizational relationships necessary to facilitate the flow of products to the end customer. Types of activities to be performed by the channel intermediaries are:

(1) Formulating channel strategy

The physical distribution design is complex task involving the integration of all system components. Frank Lynn Associates (1990) states that the strategically planned physical distribution system can provide the company with i) a better understanding of the impact corporate strategy has on physical distribution activities, 2) increased physical distribution responsiveness, 3) increased sensitivity to the distribution environment, and 4) increased awareness and understanding of distribution cost reduction and service optimization opportunities⁹.

The strategic planning process for a physical distribution system design involves an evaluation of alternate physical distribution system configurations that meet customer service requirements at the lowest total system cost (Robert E Muray1980), . Customer service goals and strategies in turn serve as the bases for the determination of inventory, warehousing, transportation, and order processing strategies and programs as well as for related investments in inventories, warehousing and distribution center facilities, transportation equipment, and management information system hardware. The next step is to specify

systems and procedures for handling physical distribution activities that are based on the physical and information inflows in the system. Finally, organization strategies are developed and translated in terms of the human resources needed to implement the system (Ibid).

(2) Designing marketing channels

The first axiom of distribution design is to consider the real value of product and service that is marketed. The designing of channel contains eight major steps; they are as follows (Louis P. Bucklin 1978)¹⁰:

- a) Examine what's being sold for value
- b) End-user segment analysis: A zero-base approach
- c) Distribution outlet design for end users
- d) Designing the ideal distribution system
- e) Analysis of the existing system
- f) Investing external and internal constraints and opportunities
- g) Assessing environmental/external drivers
- h) Delineating the options: gap analysis
- i) External analysis of objectives/constraints
- j) Confronting the constraints/ objectives
- k) Reaching the optimal distribution system/preparing for implementation

(3) Selecting channel members

Most channel compensation systems are stated in terms of margin of margin or discount structures. Companies tend to adhere to them forever and to treat them as though they were non-challengeable (Ronald D Michman and Stanley D.Sibley 1980). To select the channel members from the supplier's point of view the factors considered are as follows (Frank Lynn 1990)¹¹:

- Financial perspective of channel partner
- Sales strength
- Product lines
- Reputation
- Market coverage
- Sales performance
- Management strength
- Advertising and sales promotion programs
- Training programs
- Sales compensation programs
- Plant equipment and facilities
- Ordering and payment procedures
- After sales services

- Willingness to share ideas, cooperate programs, and commit resources

The factors considered by the channel intermediaries from the supplier's selection are (James R. Brown and Prem C Purwar 1980)¹²:

- Accepts damaged merchandise returns
- Has quick and easy ordering procedures
- Accepts unsold merchandise returns
- Provides prompt delivery
- Maintain adequate supply
- Handles complaint promptly
- Has good reputation
- Carries large product breadth
- Provides small lot delivery
- Offers frequent promotional allowances
- Requires no minimum order sizes
- Makes new product available
- Has understanding sales representative
- Provides adequate margins on suggested list prices
- Offer quality discounts
- Extend credit rate beyond certain days

- Employs well trained sales representatives
- Offers well adequate promotional support
- Offers cooperative advertising
- Provides stores displays
- Offers promotional advice for specific products

(4) Motivating channel members

In order to generate rational, equitable, and motivational marketing channel compensation systems, a basic rule of thumb that should guide the process is as follows: compensation in distribution should be given on the basis of the degree of each channel member's participation in the marketing flows (Ronald D Michman and Stanley D.Sibley 1980)¹³. In other words, channel members should be compensated for what they do rarely put to use. As Michael Porter points out in Competitive Strategy, a shakeout in the distribution system occurs as distributors scramble for bits and chunks of the remaining business, and eventually, only the weak, floundering, distributors, thereby extending their territories and gaining economies of scale and scope. As they become more and more powerful, they begin to serve as very intractable gatekeepers to the market place, and they use their positions to extract and higher and higher rents from their suppliers. In other words, they start bargaining away the manufacturer's rate of return. In the case of dealer's margins have escalated very rapidly over the years (Michael E. Porter 1980)¹⁴.

(5) Coordinating channel strategy with channel members

The major means available to achieve the coordination and cooperation by the channel members are among one another is the use of

power. Power is the ability of one channel member to get another channel member to do what it otherwise would not have done. If cooperation or coordination were to appear magically or were innate, ever present aspects of human behaviour, there would be no need to use power. But power is usually required to motivate and direct the efforts of any collectively comprised of nonclone like people (Thomas A. Stewart1989)¹⁵.

In distribution power must be used in implementing trade promotions, establishing channel support roles and standards, developing operational linkages, choosing channel partners, providing channel training, implementing joint sales programs, coordinating after sale support programs, developing reward and compensation arrangements. These activities are critical to effective channel management.

According to John Scholper,(1965) that one channel member's (A's) power over another (B) can be defined as the net increase in the probability of B's enacting behaviour after. A has made an intervention, compared with the probability of B's enacting the behaviour in the absence of A's intervention. The power of channel member is its ability to control the decision variables in the marketing strategy of another member in a given channel at a different level of distribution. For this control to qualify as power, it should be different from the influenced member's original level of control over its own marketing strategy¹⁶.

(6) Evaluating channel member performance

Performance of the channel members is usually measured in two different ways, they are i) macro or social level perspective second ii) cost-point of view, in terms of delivering the kinds of service focus.

According to the Nirmalya Kumar(1991)¹⁷ social contributions gauge measuring will be on the basis of three E's, they are

- i. Effectiveness-In macro terms the ability of channels delivered the service outputs required by the end users.
- ii. Equity- Every member of the country has the equal opportunity to use and access the marketing channel.
- iii. Efficiency-The effective ways of cost handling system to a society benefit.

According to Adel I. El-Ansary and paul H. Zinszer(eds) 1980 several key perspectives are: i) Channel design(structural) and channel management(behavioral) variables as well as channel policies determine channel performance.

ii) Environmental conditions, such as the state of the economy, technology, the law, the level of competition, and the availability of capital, have a significant impact on design, management, and policy decisions¹⁸.

According to Adel I El-Ansary (1978) the Quantitative and Qualitative measures of the channel performance areas follows:

I-Quantitative Measure of Channel Performance

- Total distribution cost unit
- Transportation cost per unit
- Ware housing cost per unit
- Production cost per unit

- Costs associated per unit
- Percentage of stock out units
- Percentage of obsolete inventories
- Percentage of bad debts
- Customer service level by product, by market segment
- Accuracy of sales forecasts
- Number of new markets entered
- Percentage of market down volume
- Number of percentage of new distributors.
- Percentage of damaged merchandise
- Size of order
- Ability to keep the new technology
- Number of customer complaints

II- Qualitative Measures of Channel Performance

- Degree of channel coordination
- Degree of cooperation
- Degree of conflict
- Degree of domain consensus
- Recognition of super ordinate goals

- Degree of channel relationship
- Degree of functional duplication
- Degree of commitment to channel
- Degree of power locus development
- Degree of flexibility in functional shiftability
- Availability of information about
 - i. Physical inventory
 - ii. Product characteristics
 - iii. Pricing structures
 - iv. Promotional data like inventory, personal selling assistance, advertising, point of purchase displays, market conditions, service available and organizational changes.
- Assimilation of new technology
- Innovation in distribution generated within the channel
- Extent of intra-brand competition
- Extent of routinization of channel tasks
- Extent of use of optimal inventory standards
- Relation with trade associations
- Relation with consumer groups

One area where considerable progress has been made in assessing distribution system performance from a micro perspective has been with regard to financial services. Robert Hedges (1986-87) has shown how the economics, objectives, and activities of the distribution system for financial services interrelate to ensure maximum impact on profitability.

Michael Levy and Michael Van Breda describes about the channel performance measuring as it is the question who should perform marketing functions and at what level can be measured with traditional accounting/financial measures. Specifically, the financing, risking, and payment functions are related to gross margin, quantity discounts, and transportation expenses. The possession/ownership functions can be measured through inventory carrying costs. The promotion function is partially measurable through advertising and personal selling expense. The ordering function is directly measurable. The profitability derived from participation in the combination of these functions provides each channel member with a basis for the final function, negotiation.

(7) Managing conflict.

Gaski and Nevin (1985) have found support for their observation that if sources of power are present but application is withheld, the consequences may be much different from, perhaps opposite, what they would be if the sources were actively exercised. For instance, the imposition of harsh sanctions on channel members (exercised coercive sources of power) seems certain to cause dissatisfaction and conflict, but the dormant presence of the potential to invoke such sanctions (unexercised coercive sources) could conceivably be regarded by franchisees or dealers as benevolent restraint. Likewise, the granting of beneficial assistance (exercised non-coercive sources) should be

favourably received, but withholding of such benefits (unexercised noncoercive sources) may not be. The fact that a channel member has power sources simply indicates that it has the potential for influence (Gary L Frazier, 1983). When it wants to change the behaviour of another channel member, it will employ a variety of influence strategies- the means of communication used in the application of a firm's power.

McCammon(1970) suggest that power resources can be converted into persuasive messages via¹⁹:

- Threats
- Legalistic pleas
- Promises
- Requests
- Recommendations
- Information exchange

Erin Anderson and Barton weitz(1989) have discussed about the channel climate as the medium is the message. For example, threats will obviously produce more conflict than will requests. In fact, the more contingent whatever is being threatened/promised/recommended, and so on, on a specific channel member's actions and are more negatively threats/promises/recommendations are framed, the worse the climate of the relationship is likely to be. Conflict in marketing channel can be viewed as the frequency and intensity of disagreements between channel members²⁰.

As Les Artman (1990) have explained the channel conflict as the intensity of conflicts can range from minor flare-ups that are easily forgotten to major disagreements marked by terminations, lawsuits, or other types of counter sanctioning. Conflict frequency can range from disputes and occasional disagreements to protracted, bitter relations. Conflict importance provides third dimensions. The combined intensity, frequency, and importance provide a general measure of conflict level that we have arbitrarily classified as low, medium, or high conflict²¹.

Miguel Villas-boas(1997), have discussed the conflict occurs due to the role performance as role performance frequently from the prescriptions established by various channel members. This deviation occurs for many reasons, the most likely being specific situational factors, incompatible organizational objectives, lack of clear and open communication flows between channel members, and differences between the deviating channel member's expectations and other members' expectations²².

Louis W. Stern and J.L.Heskett, Larry J. Rosenberg and Louis W Stern (1971) define the channel conflict as, it is a situation in which one channel member perceives other channel members to be engaged in behaviour that is preventing or impeding it from achieving its goals. It is, in essence, a state of frustration brought about by a restriction of role performance. The amount of conflict is to, a large extent, a function of goal incompatibility, domain dissensus, and differing perceptions of reality among channel members²³.

Patrick J Kaufmann and V.Kasturi Rangan(1990) pointed out as, because the franchisor's optimal number and configuration of stores in a market will generally reflect a significantly more intensive distribution

strategy than would be optimal for the franchisees, market development is a source of constant tension. Conflict over the degree of market penetration can impose severe governance costs on the franchise system: i) because of the formal and informal process that may be required to resolve intra-system disputes and ii) because of the effort involved in maintaining franchise morale. One national franchisor reported that 40 percent of its development group's time was devoted to resolving conflicts arising from new store introductions. Without any conflicts, channel members will tend to have become passive and non-innovative. Eventually, the system of which they are a part will become nonviable. Conflict motivates channel members to adapt, grow, and seize new opportunities. In fact, conflict is one of the most useful social forces available. Conflict should impel better channel performance, especially if i) moderate levels of conflict are not considered too costly by channel members, ii) divergent views produce better ideas, and iii) aggression is not irrational or destructive (K.W. Thomas and W.H. Schmidt 1976). However, because conflict is opponent-centered behavior, it can degenerate into actions calculated to destroy, injure, or thwart another party in an interdependent relationship. What one must seek to avoid is pathological conflict.-moves that are malignant for the parties involved and for the entire system itself (Kenneth E. Boulding and Elton B. McNeil (ed.,) 1965). George John (1984) has found that coercive or overly bureaucratic channel management practices can induce opportunistic behaviour, or "self interest seeking with guile". A central task in channel management is to manage conflict. In other words, ways must be found to keep conflict from becoming dysfunctional and to harness the energies in conflict situations to produce innovative resolutions. If conflict within marketing channels is to be managed, the numbers involved must eventually come to grips with its underlying

causes. The specific strategy employed will depend not only on the cause of the conflict also on the weight of power on the channel member seeking to manage the conflict (Muzafer Sheriff (1967)²⁴.

Louis W. stern and Patrick J.Kaufmann,(1985) combine the talents of various channel members from both associations in resolving conflict issues in distribution, such as those associated with ordering and building. Perhaps one of the most significant roles of a mediator might be to encourage conflicting channel members to disclose their utility functions to each other, since these functions represent risk attitudes and preferences for various outcomes. In fact, it is possible for a mediator to combine channel members often conflicting utility functions to arrive at an appropriate (or channel) utility function. This function, which also can take into account the power of the individual channel members, can be used to predict outcomes in bargaining situations (Jehoshua Eliashberg, Stephen A. LaTour, Arvind Rangaswamy, and Louis W. Stern, 1986).

Eliashberg and his colleagues have argued that the measurement and sharing of information on utilities relative to projected outcomes of negotiations might provide channel members with an input they need to predict the likely negotiation outcome and evaluate its fairness. This should make the bargaining process more efficient and perhaps more effective as well. As Eisenhardt describes it, that agency theory is concerned with resolving two problems that can occur in agency relationships. The first is the agency problem that arises when i) the desires of the principal and agent conflict and ii) it is difficult or expensive for the principal to verify what the agent is actually doing. The problem here is that the principal cannot verify that the agent has behaved appropriately. The second is the problem of risk sharing that arises when the principal and agent have different attitudes towards risk sharing that

arises when the principal and agent have attitudes toward risk. The problem here is that the principal and the agent may prefer different actions because of different risk preferences.

2.3 CONCLUSION

A prerequisite to the effective management of marketing channels is knowledge of the reasons channels exist. The intermediaries' activities are rapidly search procedures compel the existence of a large variety of intermediaries. Based on the service demand by the service output demanded by consumers. The higher the output demanded, the greater the number of institutions and agencies that will likely be required to bridge the gap between production and consumption. Service outputs are generated through the organization of the marketing functions or flows-physical possession, ownership, promotion, negotiation, financing, risking, ordering, and payment.

The actual levels of performance of these functions depend, in turn, on the economics of distribution. This requires balancing the needs of channel members to achieve profitability and manage risk, on the one hand, and the desires of consumers to receive the highest possible amount of service output at the lowest possible price, on the other hand. Therefore, there are pressures on channel members to both postpone and to speculate. In addition to these pressures, there are a host of social, political, and cultural factors impinging on channel members.
