
UNIT 1: INTRODUCTION TO PHYSICAL DISTRIBUTION

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1.0 AIMS AND OBJECTIVES

This unit introduces, an important part of marketing management, physical distribution. After completing this unit, you will be able to:

- o define business logistics, physical distribution and physical supply
- o explain the nature and importance of physical distribution
- o state the mission and objectives of physical distribution
- o describe the evolution of logistics management
- o understand logistics' place in the firm.

1.1 INTRODUCTION

In order to deliver value satisfaction to target consumers it is not only sufficient to properly price the product and sell it but it is also necessary to physically move it to the place of consumption at the time required by consumers. Economists refer to this function as the "creation of place and time utilities". Unless this function is performed, a product fails to fulfill its mission not withstanding meticulous planning of product and other marketing inputs. In marketing, the functions involved in physically moving products are collectively referred to as "physical distribution."

Physical distribution is also referred to as "marketing or business logistics" in business literature. The term logistics is borrowed from the military terminology where it is used to describe the process of transporting and supplying troops and equipment so as to have sufficient strength to meet military demands. In marketing , however, the term logistics has a broader connotation relative to physical distribution. In the following topic the meaning of physical distribution and logistics will be discussed.

1.2 MEANING OF PHYSICAL DISTRIBUTION AND LOGISTICS

A comprehensive definition of physical distribution activities, called business logistics, includes the co-ordination of the in bound and out bound activities, an emphasis on cost-effective flows, and customer service.

Physical distribution management is organizing the movement and storage of finished goods to the customer. This traditional marketing view of physical distribution management looks at only the outbound flow of finished products from the manufacturer to the customer. It fails to consider activities involving the inbound flow of raw materials and parts that often have a great impact on the success of the marketing program.

Logistics management, which involves the coordination of the movement and storing of raw materials, parts, and finished goods to achieve a given service level while minimizing the total logistics cost of the activities. This concept includes both physical supply and physical distribution that is both inbound and outbound activities. On practical level, there is no consistent use of physical distribution and logistics terms generally, and many people use them loosely. Both terms-physical distribution and logistics are used interchangeably in this course material.

Figure 1 shows the relation of physical supply, physical distribution, and logistics to the operation of a manufacturing firm. This chart shows how the firm receives its physical supply in the form of raw materials and parts from its suppliers, converts these materials and parts in its plant, and then provides physical distribution to the finished products to its customers. The concepts of physical supply, physical distribution, and logistics also apply to non manufacturing firms, such as retailers and wholesalers, for which the inbound activities include the finished goods that are sold to customers without physical modification.

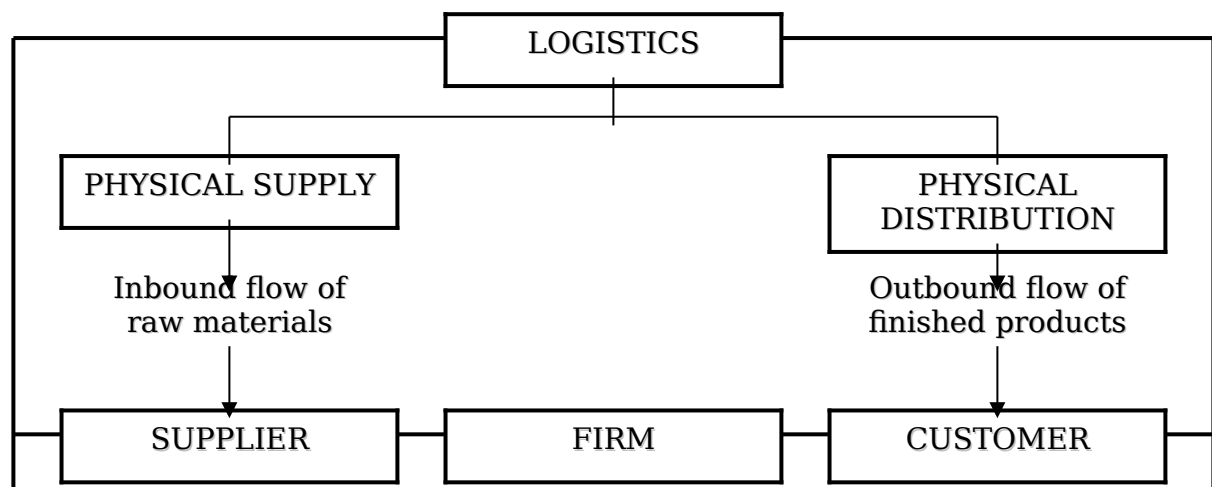


Figure 1: Relation of physical distribution and logistics to a manufacturing firm's operation

Check Your Progress Exercise 1

1. What is business logistics?

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2. Differentiate between physical distribution and physical supply.
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1.3 NATURE OF PHYSICAL DISTRIBUTION

Physical distribution involves planning, implementing and controlling the physical flow of materials and finished goods from points of origin to points of use to meet customer needs at profit.

It is basically a distribution activity of physical items. The best physical distribution methods give us the lowest cost.

The traditional distribution system starts from plants. It emphasis on how to distribute from plants. The modern physical distribution system, which is known as marketing logistics starts from market place, then to factory to satisfy customers. Thus, the marketing logistics manager's task is to coordinate the whole channel of physical distribution system, that is, the activities of suppliers, purchasing agents, channel members and customers.

1.4 THE IMPORTANCE OF PHYSICAL DISTRIBUTION

Physical distribution refers to the activities – order processing, inventory management, materials handling, warehousing, and transportations – used to move products from producers to consumers and other end users. Planning an efficient physical distribution system is crucial to developing an effective marketing strategy. Companies that have the right goods in

the right place, at the right time, in the right quantity, and with the right support services are able to sell more than competitors that do not. Physical distribution is an important element in a marketing strategy because it can decrease costs and increase customer satisfaction. Speed of delivery, service, and dependability are often as important to customers as costs.

Physical distribution deals with physical movement and inventory holding (storing and tracking inventory until it is needed) both within and among marketing channel members. Often, one channel member manages physical distribution for all channel members involved in exchanges. In fact, there is a trend toward centralization, with one marketing channel member of the entire chain.

Physical distribution systems must meet the needs of the supply chain as well as customers. A construction equipment dealer with a low inventory of replacement parts requires fast, dependable service from component suppliers when it needs parts not in stock. Even when the demand for products is unpredictable, suppliers must be able to respond quickly to inventory needs. In such cases, the distribution costs may be a minor consideration when compared with service, dependability, and time liness.

Companies are placing greater emphasis on physical distribution or logistics for various reasons. Following are some of the reasons.

- i) *Customer service:* satisfaction becomes the corner stone of marketing strategy in many business and distribution an important customer service element. Distribution is potent tool even to attract customers by reducing cost and by giving better service.
- ii) *Physical distribution:* is a major cost element for most companies. Poor physical distribution makes the company unable to survive.

- iii) *The explosion in product variety:* has created a need for improved physical distribution management. Ordering, shipping, stocking and controlling of variety of products give a challenge to physical distribution.
- iv) *Improvement in information technology:* has created opportunities for major gain in distribution efficiency. Example, use of computers.

1.5 THE LOGISTICAL MISSION

The logistical mission of an enterprise is to develop a system that meets objectives at the lowest possible birr expenditure. The logistical system is primarily concerned with support of manufacturing and marketing operations. At the policy level, the critical question is to determine the associated cost of logistical operations. Thus, the planning of logistics involves two policy considerations: (1) service performance, and (2) total cost expenditure.

The logistical performance is measured with respect to availability, capability, and quality. Availability concerns the system's capacity to consistently satisfy material or product requirements. As such, availability deals with inventory level. As a general rule, the lower the frequency of planned stock outs, the greater the investment in average inventory.

Capability of logistical performance refers to the elapsed time from receipt of an order to inventory delivery. Performance capability consists of the speed of delivery and consistency. Naturally, all firms desire to provide customers fast delivery. However, rapid delivery is of little value unless it is consistently achieved. It may hinder a firm to promise second day delivery if in actual performance the standard is achieved only a

small percentage of the time. An enterprise on the receiving end of a logistical system typically values consistency over speed of service.

Performance quality relates to how well the overall logistical task is completed with respect to damage, correct type items, and resolution of unexpected problems. There is no point in speedy delivery of a damaged product.

Quality relates to the maintenance of low error rates and a respected track record for resolving problems. Performance standards should be established on a selective basis. Some products are more critical than others because of their importance to the purchaser and their profitability.

The level of total cost has a direct relationship to the customer service policy. The simultaneous attainment of high availability, capability, and quality is expensive. The higher each of these aspects of total performance, the greater the cost of logistical operations.

The mission of the logistician is to get the right goods or services to the right place, at the right time, and in the desired condition at the lowest possible cost.

1.6 THE PHYSICAL DISTRIBUTION OBJECTIVE

From the viewpoint of logistical system design and administration, a firm must establish objectives and control several different operational areas. For most companies, the main objectives of physical distribution are decreasing costs and transit time while increasing customer service. In the following paragraphs these two main objectives will be discussed.

a) Meeting Customer Service Standards

All organizations strive to satisfy customer needs and wants through a set of activities known collectively as customer service. The level and quality

of service that a firm's management aims to provide for its customers comprise the organization's customer service standards. Many companies claim that customer service is their top priority, and clearly, without customers there would be no sales or profits-service may therefore be as important in attracting customers and building sales, as are the cost and quality of the organizations product.

Customers require a variety of services. At the most basic level, they need fair prices, acceptable product quality, and dependable deliveries. In the physical distribution area, availability, timeliness, and quality are important dimensions of customer service and frequently determine whether customers are satisfied with a supplier.

Customers seeking a higher level of customer service may also want sizable inventories, efficient order processing, availability of emergency shipments, progress reports, post-sale services, prompt replacement of defective items, and warranties. Customers' inventory requirements influence the expected level of physical distribution service.

Many companies guarantee service performance to win customers-services are provided most effectively when service standards are developed and stated in measurable terms.

b) Reducing Total Distribution Costs

Although physical distribution managers try to minimize the costs associated with order processing, inventory management, materials handling, warehousing, and transportation, decreasing costs in one area often raises them in another because physical distribution costs interact often in an inverse way.

The total cost approach involves analyzing the costs of all distribution alternatives, even those considered too impractical or expense. Total cost analyses and weigh inventory levels against warehousing expenses,

materials costs against various modes of transportation, and all distribution costs against customer service standards. In many cases, accounting procedures and statistical methods are used to figure total costs. Where hundreds of combinations of distribution variables are possible, computer simulations are helpful.

Distribution managers must be sensitive to the issue of cost trade-offs. Higher costs in one function area of a distribution system may be necessary to achieve lower costs in another.

Although management sometimes overlooks the importance of these activities, efficient order processing facilitates products flow. Computerized order processing provides a database for all supply chain members to increase their productivity. When carried out quickly and accurately, order processing contributes to customer satisfaction, decreased costs and cycle time, and increased profits.

Order handling involves several tasks. Once an order is entered, it is transmitted to the warehouse, where product availability is verified, and to the credit department, where prices, terms, and customer's credit rating are checked. If the credit department approves the purchase, warehouse personnel (sometimes assisted by automated equipment) pick and assemble the order. If the requested product is not in stock, a production order is sent to the factory or the customer is offered a substitute.

Order processing can be manual or electronic, depending on which method provides the greatest speed and accuracy within cost limits. Manual processing suffices for small volume orders and is more flexible in special situations. Electronic data interchange (EDI) integrates order processing with production, inventory, accounting, and transportation.

EDI is an information system for the supply chain that links marketing channel members and facilitating agencies together.

1.7 EVOLUTION OF LOGISTICS MANAGEMENT

Logistics activities are among the most persuasive of all human activities and involve movement and storage of goods for the purpose of achieving the desired objectives of making the right types of goods available at the right time and at the right place.

Logistics management is a managerial responsibility to design and administer a system to control the flows of raw materials, work-in-process and finished goods inventory to meet the strategic objectives of the enterprise. The goal of logistics is to achieve a pre-determined manufacturing support and marketing at the lowest possible cost.

The evolution of logistics management can be seen in five different stages or phases as follows:

a) Phase 1: (1956-1965)

In this phase, integrated logistics concept began to crystallize through

- development of total cost analysis
- the application of system approach
- increased concern for customer services
- revised attention to marketing channels

b) Phase 2: (1966-1970)

This period represented a time during which a basic concept of logistics was tested. In this period with in small firms, the initial attention was given to either physical distribution or purchasing.

Physical distribution was developed to support marketing. However, few firms simultaneously under took change in both physical distribution and purchasing practice and this period is called a time for relevancy.

c) Phase 3: (1971-1979)

This period is called a period of changing priorities. This time was a period of prolonged uncertainty in all dimensions of business due to the energy crisis and ecological concerns. Priorities changed from serving demand to maintaining supplier to overcome supplies failure that had affected this period. Therefore, there was a rapid adoption of materials management.

Physical distribution management that was originally developed were shifted to support marketing concept. Just-in-Time (JIT) concept and long term contractual agreement emerged. This period resulted in the institutionalization of logistics within the original structure.

d) Phase 4: (1980-1985)

In this period, there was a change in the area of political, technological and communicational.

e) Phase 5: (1986 up to most)

Strategic management concept is emphasized. Integrated logistic management is essential for the following reasons.

- In today's business there is a great deal of interdependence between all logistical operations. Total movement and storage provide a higher order of trade-off and greater synergetic potential.
- A narrow or restricted approach creates a potential for a dysfunctional interface (conflict interests) to a significant degree. Concepts related to solely physical distribution, manufacturing support, and purchasing place operations on diametrically opposite goals. A failure to a dominant philosophy of logistics management creates the potential for classical sub optimization.

- Control requirements for each operation are similar to the objectives of logistics. Control is to reconcile the different operational demands for each function.
- An increasing awareness of integrated logistics management that many trade-offs exist between manufacturing economies and marketing requirements can be reconciled by a well-designed logistical system.
- The complexity of contemporary logistics require innovational solutions and the challenge for company's now is to develop new way of satisfying logistical requirements.

1.8 LOGISTICS' PLACE IN THE FIRM

To see the relationship between physical distribution and other functional areas, it is better to perceive first from the logistics perspective. Firms have been carrying logistical activities of the firm in a more meaningful manner so that good management is more easily achieved. This means that some activities previously considered solely as the responsibility of production or marketing have been grouped. How does logistics fit with production and marketing?

Logistics occupies a strategic organizational position between production and marketing. Because of this, and because it is not possible to divide the activities of the firm without some overlap of responsibility for at least some of the activities, interface activities are created. These are activities that must be jointly managed by two or more functional areas. The logistician must deal with these "between production and marketing" areas.

Sample primary and interface activities of production, marketing and logistics are presented as follows.

PRODUCTION

Sample activities

- Quality control
- Detailed plant loading
- In-plant materials handling
- Equipment maintenance

MARKETING

Sample activities

- Promotion
- Market research
- Product mix
- Sales force management

LOGISTICS

Sample activities

- Transportation
- Inventory maintenance
- Order processing
- Warehousing
- Materials handling

PRODUCTION-LOGISTICS INTERFACE

- Product scheduling
- Plant location
- Purchasing

MARKETING-LOGISTICS INTERFACE

- Customer service standards
- Pricing
- Packaging
- Retail location

The primary responsibility of marketing is to generate revenue for the firm. This is done through various promotional means (advertising, price

incentive, etc), product offerings, and market research. Production is mainly concerned with the formation of the product or service and the control of its outgoing quality while minimizing the unit cost of formation. To achieve this, production has the responsibility for production system staffing, capacity planning, quality control, and process scheduling. Because logistics has the responsibility for product movement and storage, then transportation, inventory maintenance, order processing, warehousing, materials handling should be of prime concern.

Activities such as pricing or packaging should be jointly managed by logistics and marketing. Pricing has both a geographical and competitive components. Purchasing and product scheduling are examples of interface activities between logistics and production. Production must acquire goods at an acceptable cost and quality where as logistics is concerned with the location of sources of supply and the timing of these supplies. Purchasing makes these decisions. Product scheduling is a similar activity. Production is interested in the sequence and length of production runs that can be made, where as logistics is again concerned with timing and location of production. Traditional administrative arrangements group activities under several functional titles, thus requiring cross-functional coordination for a number of important logistics activities.

Check Your Progress Exercise 2

1. State the stages/phases involved in the evolution of logistics management.

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2. What are interface activities?

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1.9 SUMMARY

- Logistics management includes both physical supply and physical distribution. Physical supply refers to those activities involving the inbound flow of raw materials and parts. Physical distribution is that part of logistics, which deals with outbound flow of finished products.
- Physical distribution is basically a distribution activity of physical items. The best physical distribution system gives us the lowest cost. The tradition physical distribution system starts from plants, and emphasizes on how to distribute from plants. The modern physical distribution system, otherwise known as marketing logistics, starts from the market place, then to factory to satisfy customers.
- Physical distribution is an important element in a marketing strategy because it can decrease costs and increase customer satisfaction. Consequently, companies are placing greater emphasis on physical distribution.
- The logistical mission of an enterprise is to develop a system that meets objectives at the lowest possible cost. Many companies state their physical distribution objective as getting the right goods, to the right place, at the right time and to the least cost. However and unfortunately, no physical distribution system can simultaneously maximize customer service and minimize distribution cost. So, given the various physical distribution activities, strong trade off decision must be made on a total system basis.

- The evolution of physical distribution involves five stages or phases. Each phase is characterized by its own typical features. The last phase which is said to be modern, emphasize strategic management concept.
- Logistics occupies strategic organizational position. This is so because logistics share some joint responsibility with both production and marketing. In other words, there are production logistics and marketing logistics activities. Production logistics activities are those activities, which must be jointly managed by both production and logistics. These activities include purchasing, plant location and product scheduling. Marketing-logistics activities are activities which should be managed by marketing and logistics. Packaging, customer service, pricing and retail location are examples of marketing logistics activities.

1.10 ANSWER TO CHECK YOUR PROGRESS EXERCISES

Exercise 1

1. Business logistics is part of marketing, which deals with all move-store activities that facilitate product flow from one point of raw material acquisition to the point of final consumption, as well as the information flows that set the product in motion for the purpose of providing adequate levels of customer service at a reasonable cost.
2. Physical distribution deals with the out bound flow of finished products where as physical supply is concerned with the inbound flow of raw materials and parts.

Exercise 2

1. The stages/phases involved in the evolution of logistics management are
 - Phase 1 (1956 - 1965)
 - Phase 2 (1966 - 1970)
 - Phase 3 (1971 - 1979)
 - Phase 4 (1980 - 1985)
 - Phase 5 (1986 up to now)
2. Interface activities are those activities, which have to be jointly managed by two or more functional areas or departments.

1.11 MODEL EXAMINATION QUESTIONS

1. What is physical distribution? How is it related to business logistics?
2. Why is physical distribution important?
3. Explain the mission and objectives of logistics.
4. What is the difference between a primary and an interface physical distribution activity?
5. Logistics occupies a strategic organizational position between production and marketing. Explain.

1.12 REFERENCES

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UNIT 2: MANAGEMENT OF PHYSICAL DISTRIBUTION

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2.0 AIMS AND OBJECTIVES

This unit highlights and discusses the various aspects of physical distribution management.

After reading this unit, you should be able to

- discuss the activities of physical distribution
- describe the management of physical distribution on three levels
- explain the three important concepts of physical distribution

- understand the relationship between physical distribution and other functional areas namely, marketing and production
- understand the future in physical distribution.

2.1 INTRODUCTION

The management of physical distribution provides an exciting opportunity for improving customer services and reducing costs. For many enterprises, the physical distribution function often determines how well channels perform to satisfy customers through product availability.

Efficient distribution can increase profitability by increasing sales and reducing costs. The impact that physical distribution management can have on profits is increasing recognized in companies where major benefits are obtained by managing an integrated system of activities for satisfying customers at efficient cost levels.

Major activities that are normally grouped together in an integrated approach to physical distribution management are transportation, inventory, warehousing and order processing. Each activity with its many specific functions represents an important management task, and decisions about it must be co-ordinated with all other distribution decisions.

2.2 PHYSICAL DISTRIBUTION ACTIVITIES

2.2.1 Primary Activities

These activities are of primary importance in achieving cost and service objective of logistics. Transportation, inventory maintenance and order processing are primary logistics activities. These activities are considered

primary to effective management of logistics because they either contribute most to the total cost of logistics or they are essential to effective coordination and completion of the logistic task.

TRANSPORTATION

For most firms, transportation is the most important logistics activity simply because it absorbs, on average, approximately one-third to two-third of logistics costs. It is essential, because no modern firm can operate without providing for the movement of its raw materials and/or finished products in some way. This essential nature is always underscored by financial strains placed on many firms when freight cost increases for one or other reasons.

"Transportation" refers to the various methods for moving goods. Transportation choice will affect the pricing of products, on time delivery performance and the condition of goods when they arrive, all of which will affect customer satisfaction. Management of transportation activity involves the making of choices regarding the method of shipment, the routings, and the utilization of vehicle capacity.

Modes of Transportation

The various modes of transportation include Rail, Truck, Air, Pipeline, and Water. In the subsequent paragraphs these different modes of transportation will be discussed.

i) Rail

Railroads are one of the most cost-effective modes for shipping carload quantities of bulk products - coal, sand, minerals, farm and forests products - over long land distances. The rate costs for shipping merchandise are quite complex. The lowest rate comes from shipping carload rather than less than carload quantities. Manufacturers will attempt to combine shipments to common distances to take advantage of lower carload rates.

ii) *Truck/Highways - Also Known as Motor Carriers*

Motor carriers account for a large portion of intra city (with in cities) as opposed inter city transportation. They are highly flexible in their routing and time schedules. Regarding cost they are competitive with rail shipment and they usually offer faster service.

iii) *Water*

A substantial amount of goods move by ships and barges on coastal and inland water ways. Water transportation is very low in cost for shipping bulky, low value, non-perishable products such as sand, coal, grain, oil, and metallic ores. On the other hand, water transportation is the lowest cost transportation mode and is dependent on climatic conditions.

The major capital investment a water makes is in transport equipment, and to some extent, in terminal facilities. Waterways and harbors are publicly owned and operated. Terminal costs include the harbor fees as the carrier enters a seaport, and the costs of loading and unloading cargo. Loading - unloading times are particularly slow for water carriers, and high terminal cost are almost prohibitive for all but bulk commodities for which merchandized material-handling equipment can be used effectively.

iv) *Pipeline*

Pipelines are a specialized means of shipping petroleum, coal, and chemicals from sources to markets. Pipeline shipment of petroleum is less expensive than rail shipments although more expensive than waterway shipment. Most pipelines are used by their owners to ship their own product, although they are technically available for use by a shipper.

v) *Air*

Air carriers transport small percentage of the nation's goods but are becoming more important as a transportation mode. Although airfreight rates are considerably higher than rail or truck freight rates, air freight is ideal where speed is essential and/or distant markets have to be reached. Among the most frequently air freighted products are perishable (e.g., technical instruments, jewelry). Companies find that airfreight reduces their required inventory levels, number of warehouses, and costs of packaging.

The following table summarizes advantages and disadvantages of the five modes of transportation available.

Mode	Relative Advantage	Relative Disadvantages
Rail	- Full capacity - Extensive routes - Low cost	- Some reliability, damage problems - Not always complete pickup and delivery - Sometimes slow
Truck	- Complete pickup and delivery - Extensive routes - Fairly fast	- Size and weight restrictions - Higher cost - More weather sensitive
Air	- Fast - Low damage - Frequent departure	- High cost - Limited capability
Pipeline	- Low cost - Very reliable	- Limited routes (accessibility) - Slow
Water	- Low cost - Huge capacities	- Slow - Limited routes and schedules - More weather sensitive

Criteria For Selecting Transportation Modes

Marketers select a transportation mode based on cost, speed, dependability, flexibility, accessibility and frequency.

- ➔ **Cost:** Marketers compare alternative transportation modes to determine whether benefits from a more expensive mode are worth higher cost. When speed is less important marketers prefer lower costs.
- ➔ **Speed:** It is measured by the total time a carrier has possession of goods; including the time required to pick up and delivery, handling and movement between points of origin and destination.
- ➔ **Dependability:** Dependability of a transportation mode is determined by the consistency of service provided. Marketers must be able to count on carriers to deliver goods on time and in an acceptable condition. Along with speed, dependability affects a marketer's inventory costs, including sales lost when merchandise is not available.
- ➔ **Load Flexibility:** It is the degree to which a transportation mode can provide appropriate equipment and conditions for moving specific kind of goods and can be adopted for moving other products. Many products must be shipped under controlled humidity. Other products such as liquids or gases require special equipment or facilities for shipment.
- ➔ **Accessibility:** A carrier's ability to move goods over a specific route or network (rail lines, water ways, or truck roads) is its accessibility.
- ➔ **Frequency:** It is how often a company can send shipments by specific transportation mode. When using pipelines shipments can be continuous.

In choosing a transportation mode for a particular product, shippers consider such criteria as speed, frequency. If the goal is low cost, then

water and pipelines are prime contenders. Trucks stand high on most of the criteria, and this accounts for their growing share.

Shippers are increasingly combining two or more transportation modes, thanks to containerization. Containerization consists of putting the goods in boxes or trailers that are easy to transfer between two transportation modes. **PIGGY BACK** describes the use of rail and trucks; **FISHY BACK**, water and trucks; **TRIANSHIP**, water and rail; and **AIR TRUCK**, air and trucks. Each coordinated mode of transportation offers specific advantages to the shipper. For example, piggyback is cheaper than trucking alone and yet provides flexibility and convenience.

In choosing transportation modes, shippers can decide between private, contract and common carriers. If the shipper owns its own truck or air fleet, the shipper becomes a private carrier. A contract carrier is an independent organization selling transportation service to others on a contract basis. A common carrier provides services between predetermined points on a schedule basis and is available to all shippers at standard rates.

Transportation decisions must consider the complex trade offs between various transportation modes and their implications for other distribution elements such as warehousing and inventory. As the relative costs of different transportation modes change overtime, companies need to reanalyze their options in the search for optimal physical distribution arrangements.

Evaluating Mode/Carrier Performance

Among the criteria that are often used in measuring and controlling carrier performance are speed of service, size of order shipped, on time delivery, transit time variability and damage. In addition to day-to-day evaluation of transportation services, a periodic audit is needed in

planning, implementing, and controlling a transportation system. A transportation system audit is a comprehensive evaluation of transportation's objectives, operations, and performance. It is useful in identifying performance standards, in measuring cost and service components, and in developing procedures for managing the transportation network. Characteristics related to the distribution of the product, customer's service requirements, and geographic considerations should be identified and assessed.

Next, transportations modal alternatives, including inter modal combinations (truck plus rail), should be examined. This is followed by consideration of the relationship of transportation to physical distribution. Finally, specific carriers are evaluated. The frequency of transportation system evaluation and the selection of criteria for such evaluation should be determined as part of the system audit.

Check Your Progress Exercise 1

1. What are the primary activities of physical distribution?

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2. Outline the service criteria for selecting transportation modes.

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INVENTORY MAINTENANCE

Inventory refers to a stock of items kept in the store that is meant for future use. It is usually not possible or practical to provide instant production or instant delivery to customers. In order to achieve a reasonable degree of product availability, inventories need to be maintained as buffers between supply and demand. The extensive use of inventories results in the fact that, on the average, they account for approximately one-third to two-thirds of logistics costs, making inventory maintenance a key logistics activity.

Whereas transportation adds "place" value to a product, inventories add "time" value. In order to create this time value, inventories are placed close to customers or close to manufacturing points. The often large number of such stocking points and the high costs for carrying the products in storage, typically 25 to 30 percent of the products' value per year, require close management. The management of inventories involves keeping stock levels as low as possible while providing the desired level of stock availability for customers.

Reasons for Inventories

Stockpiling a quantity of goods now in anticipation of future use requires an investment of an organization's capital resources. It would be ideal if supply and demand could always be so coordinated that no inventories would be needed. Because it is either impractical or impossible to know future demand with certainty, and because the availability of supplies cannot be guaranteed at any given moment inventories are accumulated to assure an availability of goods and to minimize the overall costs of producing and distributing the goods.

Inventories actually serve a number of purposes. That is, they

- improve customer service
- encourage production economies
- permit purchase and transportation economies
- act as a hedge against price changes
- protect against uncertainties in demand and lead time, and
- act as a hedge against contingencies.

Let's expand on these benefits.

i) *Improve Customer Service*

Inventories are an aid to the marketing of a firm's products. Products can be spotted near where customers purchase them and in the quantities they wish to buy. This is an advantage to the customers who desire or must have immediate stock availability or short delivery times. to the supplying firm, this can mean a competitive edge and reduced lost sales, especially for those products that are service sensitive.

ii) *Encourage Production Economies*

The lowest per unit cost for producing products generally occurs with long production runs at constant quantities. Inventories act as buffers between demand and supply so that production can be geared to a more constant output than fluctuating demand might otherwise allow. A stable

work force can be maintained and the costs for frequent production set-ups avoided.

iii) *Permit Purchase and Transportation Economies*

When goods are purchased to supply the needs of production or when customer orders are served from the production line, in many cases small quantities are involved. This can mean the highest transportation rates are paid, and only minimum price discounts, if any, are realized. However, one purpose for establishing an inventory would be to allow shipping to or from the inventory under the lower per unit rates of full-vehicle-load quantities. Like wise, lower prices can be realized from price-quantity discount schedules for purchased goods, because more can be purchased at one time than is immediately needed.

iv) *Hedge Against Price Changes*

Goods that are purchased on the open market are subject to the price levels dictated by changing supply-demand patterns. Products of mines, agricultural products, and crude oil are examples of such goods. Purchases may be made in advance of need because of anticipated price increases. This creates an inventory that the logistician must manage.

v) *Protect Against Demand And Lead Time Uncertainties*

In most cases, the level of demand on a logistics system and the time required for re-supply cannot be known for sure. To assure product availability, additional amounts of stock (safety stock) are maintained. Safety stocks are in addition to the regular stock to meet production and market place needs.

vi) *Hedge Against Contingencies*

Labor strikes, fires, and floods are just a few of the contingencies that can be fall a company. Maintaining backup inventories is one way in which normal supplies can be maintained for a period of time.

It is clear that maintaining inventories offers a number of benefits, but the costs are high and risen dramatically with the interest rates on money. For the logisticians the challenge is one of minimizing the investment in inventories while balancing the efficiency needs of production and logistics with the promotional needs of marketing. The high cost of capital has made this a vital business problem.

Costs Associated with Inventories

Three different cost categories come in to play when managing inventories. These are (1) carrying costs (2) procurement costs, and (3) out-of-stock costs.

- (1) *Carrying Costs:* carrying costs refer to all the costs associated withholding a quantity of goods for a period of time. This is actually a term that represents a number of costs. First, there is the cost of capital. Inventories tie up capital that could be put to use in other ways inside the firm. The cost of capital is usually considered to be the interest rate on money charged by banks to their best customers.

Second, there are inventory service costs such as taxes and insurance. Property tax levied on the assessed value of the company's assets is part of the inventory carrying costs. Insurance costs for fire and theft protection of inventories are only indirectly related to the amount of stock maintained. However, they have traditionally been accounted for as a carrying cost.

Third, there are storage-space costs. These are the recurring costs for storage that relate to the amount of inventory on hand.

Fourthly, there are the inventory risk costs. These are the costs of stock becoming unsaleable due to deterioration or obsolescence, damage, and pilferage.

The overall cost of carrying inventories is surprisingly high to many business people. Traditionally, a figure of 25% per year of the average value of inventory maintained has been assumed.

- (2) *Procurement Costs:* are costs associated with acquiring the needed quantities for stock replenishment. When an order is placed, a number of costs are incurred as a result of order processing and preparation. More specific, procurement costs include (a) the cost of processing an order through the order-processing, accounting, and/or purchasing departments; (b) the cost of transmitting the order to the supplier; (c) the cost of setting up production to produce or setting up handling procedures to fill the order quantity, (d) the cost of any materials handling or processing of the order at the receiving dock; and (e) the price of the goods. Production setup costs may not be relevant to an inventory decision if goods are purchased from outside suppliers. Also, transportation cost and price may not be relevant if there are no volume rate breaks.

- (3) *Out of Stock Costs:* when there is demand for goods that are not in stock, out-of-stock costs are said to be incurred. Depending on how the potential buyer reacts to the out-of-stock situation, one of two types of costs can occur: (a) lost sales costs, or (b) backorder costs.

Lost sales costs are encountered when a customer withdraws his or her order for the product when an out of stock occurs. The cost sales cost is the profit that is foregone on the sale, as well as any profits that may not be realized in the future due to the negative effect that the out of stock may have on customer goodwill. Products that are highly

substitutable such as cigarettes, foodstuffs, and aspirin tablets incur the lost sales cost. Actually, it is an opportunity type cost because there is no direct expenditure of birrs. It is also difficult to estimate because it requires predicting consumers' future intention about buying the products.

Back order costs are more measurable, and do result in direct birr expenditures by a firm. When a customer is willing to delay purchasing of a product until an out of stock situation can be corrected, certain additional costs are incurred by supplying the order. These back orders can result in additional clerical and sales costs for order processing, and in additional transportation and handling costs when such orders must be filled outside of the normal distribution channel. Products that are likely to be back ordered are those that can be fairly well differentiated in the customer's mind. Automobiles and appliances are examples of products that customers may wait for. **Key:** immediately available from the stock on hand.

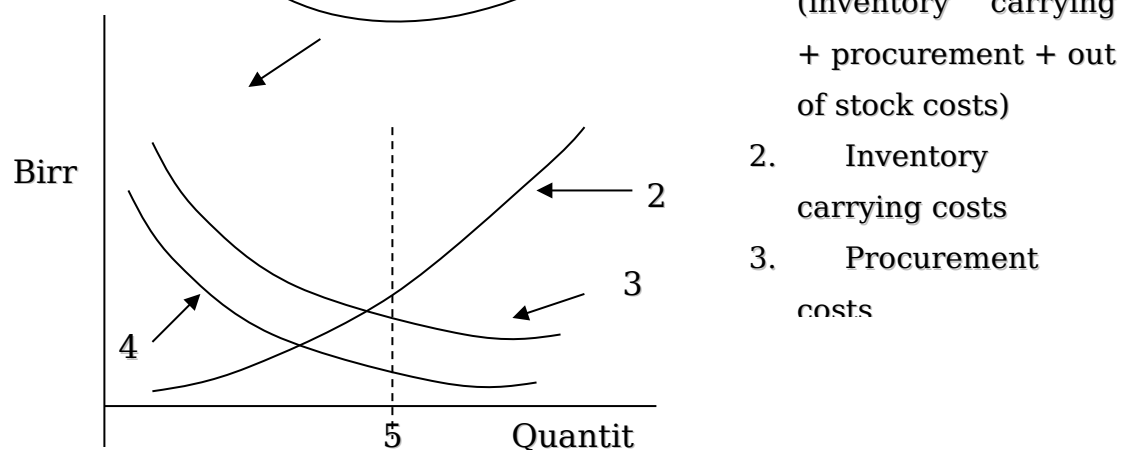


Figure 2: Inventory Investment for Various Service Levels

ORDER PROCESSING

Order processing costs tend to be minor compared to transportation or inventory maintenance costs. Nevertheless, order processing is a primary logistics activity. Its essential nature comes from the fact that there is a critical time element in getting goods and services to customers. It is also the primary activity that triggers product movement and service delivery.

As an activity that acts as a trigger for the goods to fulfill the demand requirements, order processing involves a number of sub activities that every logisticsian should be aware of if he or she is to efficiently manage product flows. These activities include order entry, order status reporting and invoicing.

2.2.2 Supporting Activities

Supporting activities are those activities carried out by the logistics organization that support the primary activities. These are:

- a) Warehousing
- b) Materials handling
- c) Protective packaging
- d) Acquisition
- e) Product scheduling
- f) Information maintenance

A) WAREHOUSING

Warehousing refers to the management of the space required to hold inventories. It involves such problems as site selection, space determination, stock layout, stock retrieval, dock design, and warehousing configuration.

Important Functions/Purposes of Warehouses

Warehouses provide a key link in the physical distribution chain. The location, size, and capabilities of warehouses can proudly affect a

company's credibility to satisfy its customers and deliver products profitability.

Modern warehouses are clean, computerized, and efficient, and they are used for a variety of purposes:

- ➔ **Storage:** not surprisingly, companies store things in warehouses. However, storage is more than just goods waiting for delivery to customers; warehouses can also be used for product seals (aging caps with wishes), and blending (coffee beans, for example).
- ➔ **Breaking Bulk:** to keep transportation costs down, warehouses are often used to break bulk. This happens when a centrally located warehouse receives a large shipment, then breaks it down into smaller shipment intended for local distribution. By limiting the number of shipment made over long distances, breaking bulk takes some of the bite out of transportation costs.
- ➔ **Consolidation:** on the other hand, warehouses can be used to consider a number of small shipments to make one large shipment. For example, this is frequently done with overseas transportation to reduce the number of individual shipments.
- ➔ **Unitization:** it refers to collecting many smaller packages together in a larger, single load. Products are often unitized to make their transportation faster and easier.
- ➔ **Containerization:** the next step up from unitization is containerization, collecting goods into large containers for more efficient shipment by truck, train or ship.

Types of Warehouses

Warehouses can be classified into different categories by taking two basic points as bases. Based on ownership, warehouses are classified into

private, public, and bonded. Based on the commodity they store, warehouses can be general, special, or refrigerated.

Based on ownership:

- ➔ **Private warehouses:** are owned by individuals or group of individuals who rent for future price advantage, rent advantage, and so forth.
- ➔ **Public warehouses:** are those warehouses governed by the government. These warehouses serve who so ever is able to meet the payment.
- ➔ **Bonded warehouses:** are special warehouses constructed around airports, seaports, and so forth. They harbor imported goods or products to be exported until the importer or the exporter pays the customs charges.

Based on the commodity they store:

- ➔ **General warehouses:** are warehouses constructed for any kind of product without any special commodity specification.
- ➔ **Special commodity warehouses:** are those warehouses, unlike general warehouses, constructed for accommodating special products, coffee for example.
- ➔ **Refrigerated warehouses:** are those warehouses that are specially designed for perishable products. They are designed to keep temperature as per requirement for different perishable products like fruits, eggs, flowers, milk and so forth.

A major advancement in both public and private warehousing is the distribution center, a specialized facility designed to rapidly direct goods from suppliers to store or final consumers. Distribution centers use advanced equipment and computers to receive, sort, reload, and route tens or hundreds of thousands of packages daily.

Materials handling goes hand in hand with warehousing, and it also supports inventory maintenance. It is an activity that is concerned with the movement of the product at the stocking point—for example, transfer of goods from warehouse receiving point to storage location and from storage location to warehouse delivery point. A number of problems are important to materials handling, such as selecting materials handling equipment, order picking procedures, and workload balancing.

Product, or materials, handling is the problem of moving small quantities of goods over relatively short distances compared with the longer-haul product movement by transportation companies. It is an activity that takes place in warehouses, production facilities, and retail stores, and also between transportation modes. The concern is to be able to move the goods with speed and low cost. Because the handling activity must be repeated many times, what may be minor inefficiencies in any one trip can add up to substantial diseconomies when taken over many products and a period of time. Materials handling equipment and methods have shown more progress in improving efficiency than perhaps any of other logistical activities.

C) PROTECTIVE PACKAGING

One of the objectives of logistics is to move goods with no more damage than is economically reasonable. Good design of the package for the product's protection helps to assure damage-free movement. In addition, proper package dimensions encourage efficient storage and handling.

Product package has three important aspects. First, the package is a tool for product promotion and use. Second, it provides protection for the product. Finally, it is an instrument for improved distribution efficiency. Designing a package therefore requires consideration of a number of interest areas.

Packaging for the Customer

Walk into any modern retail store and note the colorful array of products. Products? No, packages! The packages may be necessary to protect products, but marketers have used them to good advantage in promoting their firms' products. Consider just a few of the ways.

First, the package provides an attractive method for getting the company's message across the customers. It may be used to convey price information and the virtues of the product. The package is an advertisement.

Second, the package dimensions may have to conform to shelf-space requirements in stores. This offers consumers the greatest exposure to

the product among the other products competing for the same shelf space.

Finally, the package may offer some utility that enhances the product.

Packaging for Protection

One of the basic reasons for incurring the added expense of packaging is to reduce the occurrence of damage, loss through theft or misplaced goods, or spoilage. The greatest concern of the logistician for most of the products that must be handled is damage.

Packaging for Distribution Efficiency

The final concern is how the package affects the efficiency of handling, storing, and moving the product. These are some of the most important concerns to the logistician in package design.

D) ACQUISITION

Acquisition is the logistics activity that makes the product available to the logistics system. It is concerned with the selection of supply-source locations, quantities to be acquired, timing of purchases, and the form in which the product is to be acquired. The importance of acquisition to logistics is that buying decisions have geographical and time dimensions that affect logistics costs. Acquisition should not be confused with purchasing. Purchasing includes many of the detail of the buying process (for example, price negotiation and vendor rating) that are not specifically related to the logistics task, hence the substitute term of acquisition used.

Acquisition, or purchasing, refers to those activities that take place between the organization and its suppliers. Purchasing generally brings to mind the idea of buying. The term acquisition is used here to mean those aspects of purchasing that affect the availability and flow of the supply product. Although product price and quality are vital

considerations for choosing any supplier, the third key element is delivery.

To some organizations, logistical management of supply side activities may be of little concern. This is not because these activities are unimportant, but because there may be relatively little control over supply movements. Delivered pricing arrangements, lack of receiving inventories, and lack of control over transport services may place the acquisition activities outside the logistician's interest. More often than not, however, the organization is able to exercise a degree of control over the logistics activities of its supply channel. To many organizations, especially service organizations, the most important logistical problems often center on the acquisition activity.

The logistics problems of supply management are only slightly different from those of physical distribution. Acquisition in supply management is more a matter of selecting among a limited number of supply sources, where as physical distribution is concerned with distributing to customers located at many points. Also, the volumes moved per shipment tend to be larger in the supply channel than those in the distribution channel.

The benefits to the organization for good management of acquisition are quite impressive. Normally, a firm spends between 40 and 60 percent of its sales birr for purchased materials. Even small reductions in the cost of purchased materials, whether through lower price or more efficient movement, can have a dramatic effect on profitability.

E) PRODUCT SCHEDULING

Whereas acquisition relates to the supply (in bound) side of a manufacturing firm, product scheduling relates to the distribution (out bound) side. It refers primarily to the aggregate quantities to be produced and where and when they should be produced. It does not refer to the

detailed production scheduling that is carried out on a daily basis by production planners.

Because productive capacity is limited and often dispersed geographically, providing the right goods at the place and time needed for production becomes a critical concern as goods flow from suppliers through the productive facility and on to customers.

Timing the convergence of materials for the production process greatly affects the efficiency with which the process can be carried out. Therefore, production scheduling is not just a production process management problem, but it involves logistical considerations as well.

The logistician is more concerned with the aggregate production schedule than the detailed one. In fact, it is becoming more the case that the corporate logistician specifies the overall product requirements that are needed to meet demand. It is production's responsibility to create the product in quantities and at locations at which company costs can be minimized. The details of bringing land, labor, and capital together are generally production concern rather than a logistics concern.

At any given producing location, the questions of what quantities to produce and when to produce them are important concern because raw material flows must be planned, as well as provision made for transportation and storage of both raw materials and finished goods. The question of where goods should be produced involves all the activities in the logistics mix.

Production scheduling at a given location has two distinct problems. First, there is planning the timing of material flows, or aggregate planning. Second, there is planning the sequence in which products are to be produced.

F) INFORMATION MAINTENANCE

No logistics function within a firm is likely to operate very efficiently without necessary cost and performance information. Such information is essential to good logistics planning and control. Maintaining a database of important types of information-for example, customer locations, sales volume, shipping patterns, and inventory levels supports efficient and effective management of both primary and supporting activities.

Check Your Progress Exercise 2

1. What purposes do inventories serve?

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2. Outline the various supporting physical distribution activities.

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3. What is the importance of information to logistics?

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2.3 MANAGING PHYSICAL DISTRIBUTION ON THREE LEVELS

The management of physical distribution is a job that is carried out on three levels: (1) strategic, (2) tactical, and (3) operational. The strategic level deals with the strategic planning problem. That is, deciding in a broad sense what the overall system configuration should be for distribution. More simply, it is the placing of the warehouses, the selecting of the transportation modes, and the designing of the order processing system. Strategic planning shapes the distribution system in broad general terms.

Physical distribution management at the tactical level is resource utilization. In many respects, it is short-range planning. When a firm invests in some part of the distribution system, such as trucks, warehouses, order-transmittal equipment, or materials handling equipment, there is the problem of using this owned equipment and these facilities efficiently this is a tactical problem. If transportation equipment could always move fully loaded, if warehouse space could always be fully occupied, and if order transmittal equipment were never idle, the cost of ownership would be at a minimum. Therefore, by the careful planning of distribution flows on a routine basis (often a daily basis), management attempts to achieve the highest utilization possible.

Operational management refers to the daily tasks that a distribution manager and subordinates perform to assure that the product moves through the distribution channel and on to the ultimate consumer. This includes such activities as picking product from warehouse stocks, loading trucks for delivery, packaging product for shipment, keeping track of inventory levels, preparing stock replenishment orders etc. The focus of this aspect of distribution management is mainly supervision and task accomplishment.

Strategic - what should our distribution system be? Tactical - how can the distribution system best be utilized? Operational - let's get the goods out! This is a way of classifying distribution management. It should be obvious from the brief foregoing discussion that a great portion of top management's job involves strategic planning. Middle management is most heavily involved in tactical planning, and supervisory personnel are involved in more of the operational activities.

2.4 THREE IMPORTANT CONCEPTS OF PHYSICAL DISTRIBUTION

By this point in the discussion, at least some general ideas as to what the strategic distribution problem should be established. But how can one approach such seemingly complex problems? There are some basic concepts that help. These are (1) cost trade offs, (2) the total cost concept, and (3) the total system concept. It was the recognition of these important principles that led to the grouping of logistics activities, as they are currently defined. They represent capstone ideas for physical distribution management.

(1) The Cost Trade-off

The concept of the cost trade-off is fundamental to physical distribution management. Without it, physical distribution management would probably not be practiced as we know it today.

The cost trade-off concept is the recognition that the cost patterns of the various activities of the firm sometimes display characteristics that put them in economic conflict with one another. Consider the pattern of costs shown in Figure 3 for the three primary logistics activities as they are influenced by the selection of the number of warehouses in a distribution system. Notice that as the number of warehouses is increased, transportation costs decline. This is because bulk shipments can be made to warehouses at low volume rates.

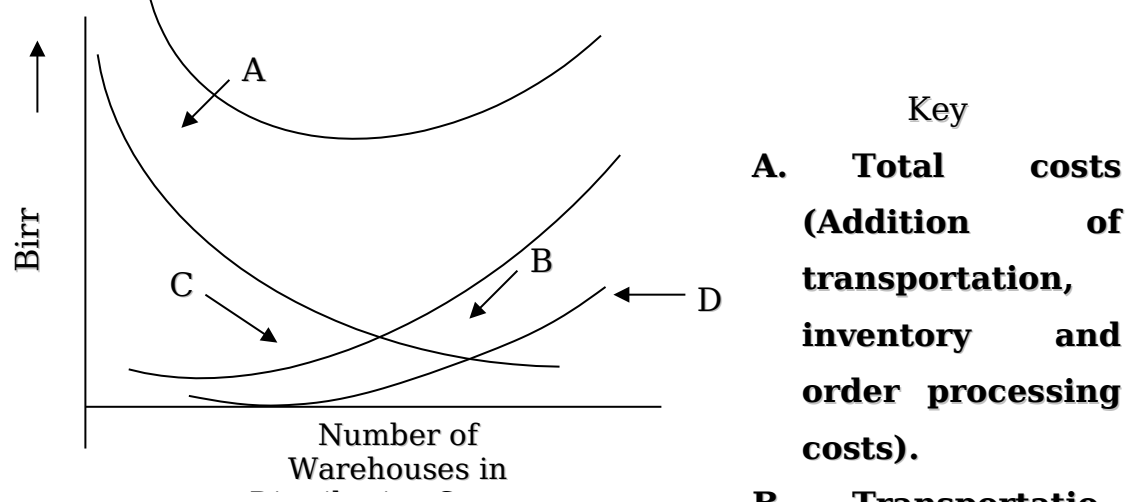


Figure 3: Basic cost trade offs in determining the number of warehouses in a distribution system.

Also, the distance that small-volume shipments must move from warehouse to customer is reduced, lowering out bound transportation costs. Thus the combinations of warehouse inbound and outbound transportation costs shows a cost pattern that declines with increasing numbers of warehouses.

On the hand, inventory and order processing costs show the opposite pattern to transportation costs and are therefore said to be in conflict with them. Inventory costs increase with the number of warehouses because more stock is needed to maintain the same level of stock availability than with fewer warehouses. Order processing costs may also increase with the number of warehouses if the warehouses serve as order processing points.

To make a decision as to the number of warehouses, the manager tries to balance or "trade-off" the conflicting costs. This achieves the lowest cost distribution system.

(2) The Total Cost Concept

The total cost concept and the cost trade off go hand in hand. The total cost concept is the recognition that conflicting cost patterns should be examined collectively and balanced at optimum. As show in Figure 3, the total relevant cost for the number of warehouses is the addition of the three costs to form a total cost curve. Note that the least-cost point on this curve is not at the point where the transportation cost is minimum or where inventory or order processing costs are minimum. Rather the least cost point lies at a point between these. It was recognized that managing transportation, inventories, and order processing activities collectively could lead to substantial cost reduction when compared with managing

them separately. The total cost idea was instrumental in deciding which of a firm's activities should be grouped together and called physical distribution activities. Further, it provided the basic argument for the collective management of the logistics activities as identified in this unit.

It is a general rule in distribution that the faster and more reliable the transportation service, the lower the inventory requirement on both ends of the goods movement. In addition, the speed of goods movement affects the length of time that money is tied up in inventories while goods are in transit.

The essence of the total cost concept is to consider all the relevant cost factors in a particular decision, add them to form the total cost, and search for the minimum total cost alternative.

(3) The Total System Concept

The third important principle is the total system concept. This concept is an extension of the total cost concept and is probably one of the most over used, under defined terms in business today. It represents a philosophy for distribution management that considers all those factors in a decision that are in some way affected by the outcome of the decision. For example, in choosing a mode of transportation, the total cost concept would encourage us to consider the impact of the decision on the firm's inventories. On the other hand, the total-system concept would encourage us to consider the impact of the transportation choice on the buyer's inventories as well.

The total system approach is to look broadly at distribution problems in order to uncover relationships that if neglected, could lead to sub optimal decisions. This approach is particularly important to logistics because so much of logistics management interfaces with other functional areas within, and beyond, the legal boundaries of the firm.

2.5 PHYSICAL DISTRIBUTION VERSUS OTHER FUNCTIONAL AREAS

Physical distribution is the newest member of the organizational team. Marketing and production are established areas within many firms. What is the relationship of physical distribution to these areas.

2.5.1 Relationship to Marketing

Paul converse, a leading authority and teacher of marketing some years ago, referred to physical distribution as "The Other Half of Marketing". Most leading textbooks on marketing identify physical distribution as a key part of the subject matter. For example, Jerome McCarthy defines the marketing mix as made up of product, place (physical distribution), promotion and price.

Why do marketing people consider physical distribution to be such an integral part of the marketing function? The answer lies in the basic mission of marketing as practiced by most firms, that is, to generate the revenue for the firm. Physical distribution contributes to this mission. Richard Lewis has suggested that marketing has two basic purposes. One is the obtaining demand, and the other is the servicing of demand. The two are linked by the customer service level provided.

Obtaining demand is a result of the promotional efforts of marketing, as well as the price and product mix offered to consumers. Once the demand has been secured, it must be served. This is where physical distribution comes in. The physical distribution effort put the right product in the right place at the right time to meet demand requirements. If there were no more to the relationship than this, the demand obtaining and demand servicing activities could easily be separated. But sales people have long recognized that physical distribution actually contributes to creating

demand. Product availability, prompt delivery, and accurate order filling are just a few of the services that can please a customer. Sales can be generated by good service. It is the service level that binds the promotional and distribution efforts together. Figure 4 illustrates the relationship.

Conversely, marketing efforts can help to control physical distribution.

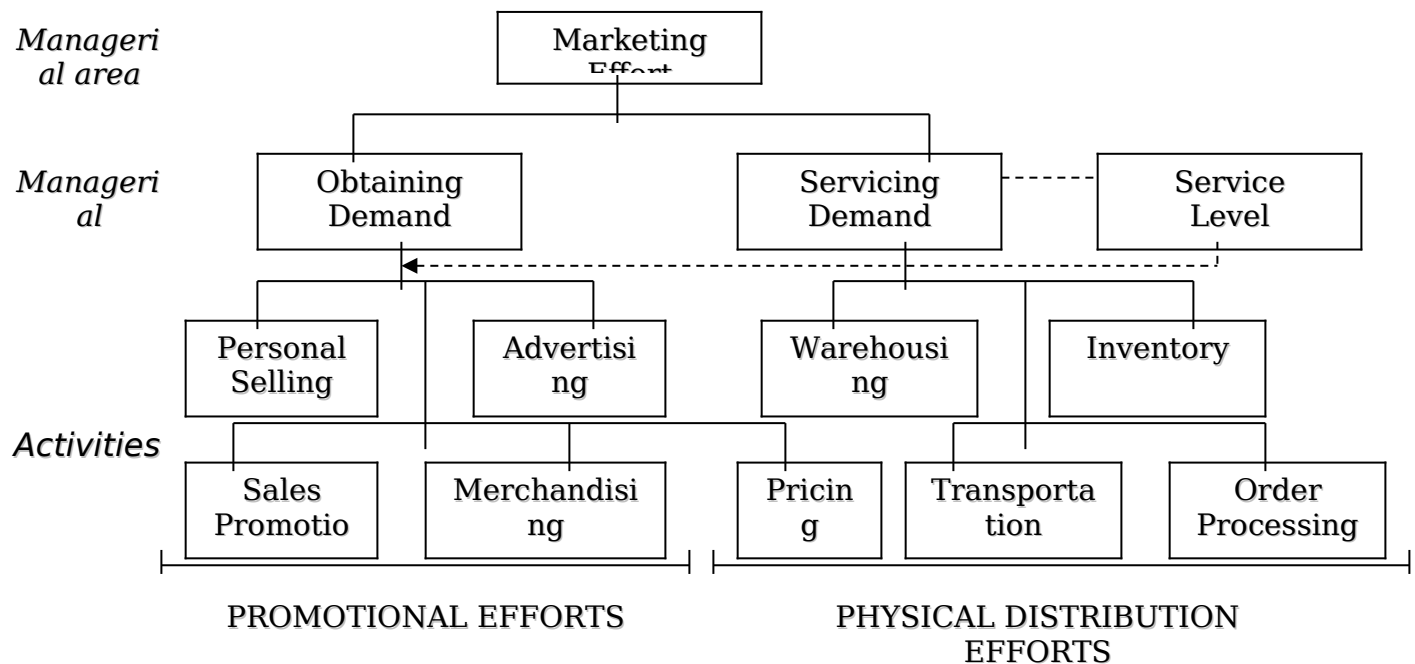


Figure 4: Dividing the marketing efforts into its demand obtaining and demand servicing activities.

2.5.2 Relationship to Production

Production has been defined as the process by which goods and services are created. Recently, there has been a movement to broaden the concept of production into "operations". Operations not only include manufacturing activities but service producing activities as well. Some have suggested that logistics activities are a part of production, or that they can be integrated into production concepts. No attempt is made here to resolve the argument as to whether physical distribution is a part of production. Rather, it should be recognized that producing activities and

goods moving activities overlap to a substantial degree. It is at this interface that the production/physical distribution relationship occurs.

This relationship has not been as well defined as the one between physical distribution and marketing. Nevertheless, the relationship is strong. It occurs in at least two ways: (1) around the scheduling of replenishment of orders for warehouses, and (2) around the product loading at plants.

It is often a distribution responsibility to initiate replenishment orders to replace field warehouse stocks. If carried out without regard for production costs, production may be forced into poor product sequencing and short production runs. On the other hand, if production disregards distribution cost in its product scheduling decisions, distribution costs may be too high, due to the uneconomic transportation patterns and inflated inventory levels that are forced into the distribution system. Better coordination between the timing and the quantities flowing is needed.

Second, distribution patterns usually determine the quantities and the product types produced at each of the plants that make up a multiple-plant network. How the demand is assigned to the plants can greatly affect total production costs. Therefore, plant loading and goods movement patterns must be planned as a joint program.

Physical distribution activities are strategically linked to the production and sales functions in a firm. Each function claims an interest in the physical distribution activities, and rightfully so. The management of performance of each function is affected by distribution activity levels. When this is fully appreciated, we can see that it is not important to concern ourselves with whether physical distribution is a part of production or a part of marketing or a separate managerial function of equal status with production and marketing. What is important is that

effective coordination be achieved among the various distribution activities so that the cost trade offs of physical distribution are exploited.

Check Your Progress Exercise 3

1. What are the three levels on which the management of physical distribution is carried out?

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2. State the three important concepts of physical distribution.

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3. What is meant by obtaining demand?

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4. The relationship between physical distribution and production occurs in at least two ways. What are these?

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2.6 THE FUTURE IN PHYSICAL DISTRIBUTION

Executives involved in physical distribution face tremendous challenges and opportunities in the years ahead. These pressures originate both within their companies and from external environmental forces.

Within most firms there is a need to coordinate physical distribution activities more effectively so that they function as a system. Essentially this is a problem in organization. If you ask, "Who is in charge of physical distribution?" all too often, the answer is "No one". These activities often are not coordinated. Managerial responsibility is fragmented among units that may have conflicting goals. Fortunately, there is a trend toward the establishment of a separate department responsible for all physical distribution activities.

It is imperative that top management view logistics as one of its prime responsibilities. Physical distribution costs are the largest single operating cost in many firms. For countless companies, effective customer service (which involves physical distribution activities primarily) can mean the difference between a strong and a weak marketing position. Once the top executives become aware of the stakes, they are likely to play an active role in logistics management. If these internal conditions are not sufficient incentive, then certainly the macro environmental forces should do the job.

2.7 SUMMARY

Physical distribution activities are broadly categorized as primary activities and supporting activities. Primary activities include transportation, inventory maintenance and order processing. Supporting activities are those activities carried out by the logistics organization that support the primary activities. These are warehousing, materials handling, protective packaging, acquisition, product scheduling and information maintenance.

Transportation is the most important logistics activity that deals with the various methods for moving goods. The various modes of transportation include rail, truck, air, pipeline, and water. Marketers select a

transportation mode based on criteria like cost, speed, dependability, flexibility, accessibility and frequency.

Inventory maintenance is another important logistics activity. It is usually not possible or practical to provide instant production or instant delivery to customers. The reasons or purposes for inventories are to improve customer service, to encourage production economies, to permit purchase and transportation economies, to act as a hedge against price changes, to protect against uncertainties in demand and lead time, and to act as a hedge against contingencies.

There are three costs associated with inventories. These are carrying costs, procurement costs, and out-of-stock costs.

Warehousing refers to the management of the space required to hold inventories. Warehouses serve important purposes like storage, breaking bulk, consolidation, unitization and containerization. Private warehouses, public warehouses, bonded warehouses, general warehouses, special commodity warehouses, and refrigerated warehouses are the various types of warehouses.

Materials handling is a supporting activity that is concerned with the movement of the product at the stocking point. It deals with a number of problems such as selecting materials handling equipment, order picking procedures, and workload balancing.

As one of the supporting activities of physical distribution, protective packaging has three important aspects. These are packaging for the customer, packaging for protection and packaging for distribution efficiency.

Acquisition is concerned with the selection of supply-source location, quantities to be acquired, timing of purchases, and the form in which the

product is to be acquired. It is the logistics activity that makes the product available to the logistics system.

Product scheduling refers primarily to the aggregate quantities to be produced and where and when they should be produced.

Information maintenance is invaluable logistics activity. Cost and performance information is essential to good logistics planning and control.

Strategic, tactical, and operational levels are three levels on which the management of physical distribution is carried out. Strategic - what should our distribution system be? Tactical - how can the distribution system best be utilized? Operational - let's get the goods out! This is a way of classifying distribution management.

Cost trade offs, the total cost concept, and the total system concept are the three important concepts of physical distribution.

Physical distribution has a close relationship with production and marketing. It complements/supports the activities of both production and marketing.

2.8 ANSWER TO CHECK YOUR PROGRESS EXERCISES

Exercise 1

1. The primary activities of physical distribution are transportation, inventory maintenance and order processing.
2. The service criteria for selecting transportation modes include cost, speed, dependability, flexibility, accessibility and frequency.

Exercise 2

1. Inventories serve the following important purposes
 - improve customer service

- encourage production economies
 - permit purchase and transportation economies
 - act as a hedge against price changes
 - protect against uncertainties in demand and lead time, and
 - act as a hedge against contingencies.
2. The supporting physical distribution activities are warehousing, materials handling, protective packaging, acquisition, product scheduling and information maintenance.
 3. The importance of information to physical distribution is for proper logistics planning and control.

Exercise 3

1. Strategic, tactical, and operational levels are the three levels on which the management of physical distribution is carried out.
2. Cost trade offs, the total cost concept, and the total system concept are the three important concepts of physical distribution.
3. Obtaining demand refers to creating demand for goods and service through promotional efforts of marketing, as well as the price and product mix offered to consumers.
4. The relationship between physical distribution and production occurs in at least two ways. These are:
 - o Around the replenishment of orders for warehouses
 - o Around the product loading at plants.

2.9 MODEL EXAMINATION QUESTIONS

1. What are primary logistics activities, and how do they differ from interface activities?
2. How does transportation contribute to "place" value in a product or service? How does inventory add to "time" value in products or services.
3. Briefly describe the different types of warehouses.

4. Explain the following concepts
 - Total cost approach
 - Cost trade off concept
 - Total system approach
5. What trends and developments are likely to characterize physical distribution efforts in the future?

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UNIT 3: THE RETAIL MARKET AND RETAILING INSTITUTIONS

Contents

- 3.0 Aims and Objectives
- 3.1 Introduction
- 3.2 Middlemen and Channels of Distribution
 - 3.2.1 Middlemen
 - 3.2.2 Channels of Distribution
- 3.3 Basic Retailing Terms
- 3.4 Nature of Retail Market
- 3.5 Retailing's Place in the Marketing Channel
- 3.6 Functions Performed by Retailers
- 3.7 Classification of Retailing
 - 3.7.1 Store Retailing

3.7.2	Non Store Retailing
3.8	Retailer Marketing Decisions
3.9	The Future of Retailing
3.10	Summary
3.11	Answer to Check Your Progress Exercises
3.12	Model Examination Questions
3.13	References

3.0 AIMS AND OBJECTIVES

The purpose of this unit is to discuss in detail the retail market and retailing institutions. After completing this unit, you will be able to

- explain middlemen and channels of distribution
- define basic retailing terms
- understand the nature and importance of retail market
- know retailing's place in the marketing channel
- describe the functions performed by retailers
- know the various classifications of retailing outlets
- state retailers' marketing decisions
- understand the future of retailing.

3.1 INTRODUCTION

Retailing entails the business activities involved in selling goods and services to consumers for their personal, family, or household use. It may be viewed from the perspectives of manufacturers, service firms, consumers, and traditional retailers. It includes tangible and intangible items, does not have to use a store, and can be conducted by manufacturers and others as well as by retail firms.

Retailing is the last stage in a channel of distribution, which contains the businesses and people involved in the physical movement and transfer of ownership of goods and services from producer to consumer. In a

channel, retailers perform many valuable functions as the intermediaries between manufacturers, wholesalers, and other suppliers and final consumers. Via the sorting process, retailers collect an assortment of goods and services from various suppliers and offer them to customers. Retailers communicate with customers and with other channel members, like manufacturers and wholesalers. Retailers may ship, store, mark, advertise, and pre-pay for items. They complete transactions with customers and often provide customer services.

Retailers and their suppliers have complex relationships because retailers serve two roles. They are part of a distribution channel aimed at the final consumer, and they are also major customers for their suppliers. Thus, divergent viewpoints may occur, and they must be reconciled. Channel relations are smoothest with exclusive distribution; they are most volatile with intensive distribution. Selective distribution combines aspects of both in an attempt to balance sales goals and channel member cooperation.

Retailing has several special characteristics. The average size of a sales transaction is small. Final consumers make many unplanned purchases. Most retail customers must be drawn to a store location. In this unit the retail market and retailing institution will be discussed.

3.2 MIDDLEMEN AND CHANNELS OF DISTRIBUTION

3.2.1 What Are Middlemen?

Middlemen are institutions or individuals situated in the marketing channels at points between producers and final buyers. A middleman renders services in connection with the purchase and/or sale of products moving from producers to customers. A middleman either takes title to the merchandise or actively aids in the transfer of ownership.

Accordingly, middlemen are commonly classified as merchant middlemen and agent middlemen. Merchant middlemen actually take title to the goods. Agent middlemen like brokers and manufacturers' agents never actually take title to the goods, but they do actively assist in the transfer of title. The two major groups of merchant middlemen are wholesalers and retailers.

Middlemen takeover some of the burden of marketing from producers. The marketing functions they perform include buying, selling, grading, risk taking, and developing and maintaining information database.

3.2.2 What Are Channels of Distribution?

Channels of distribution otherwise known as marketing channels can be viewed as sets of independent organizations involved in the process of making a product or service available for use or consumption by the consumer or industrial user. In other words, they are the routes that products follow as they are bought and sold on their way to the ultimate consumer or industrial user. A channel always includes both the producer and the final customer for the product, as well as middlemen involved in the title transfer. Even though agent middlemen do not take actual title to the goods, they are included as part of a distribution channel. This is because they play an active role in the transfer of ownership.

Distribution channels are either direct or indirect. A channel of distribution is said to be direct when products move directly from the producer to the final consumer or industrial user. Where as a distribution channel is referred to as indirect when products pass through various intermediaries or middlemen. Distribution channel decisions are among the most complex and challenging decisions facing a firm.

3.3 BASIC RETAILING TERMS

- **Retailers:** Businesses or individuals that sell more of their goods and/or services to final consumers in small quantities.
- **Retailing:** Basically it is defined as the selling of goods or services individually or in small quantities directly to the consumer for personal, non-business use. It is also often referred to as marketing at the level of the final consumer.
- **Retail mix:** A combination of activities - planning physical facilities, determining merchandise or services, pricing, promotional services, finance, and control - engaged in by retailers in an attempt to satisfy their target markets.
- **A retail sale:** A sale made by any firm-manufacturer, wholesaler or retail store to ultimate consumers for their personal and non-business use.
- **Guiding premise of retailing:** The assumption that retailers must have the right merchandise at the right time, in the right place, at the right price, and in the right quantity in order to satisfy their customers and make a profit. This basic premise of retailing should be thought of as the foundation for all retail decision making.

3.4 NATURE OF RETAIL MARKET

Retailing is omnipresent (everywhere all the time), educational, dynamic, and challenging. It is as old as biblical markets and as new as the personal computer. It is small town and big city, local and regional, national and international. It is the most important link in the distribution chain from producer to consumer, for almost all of our gross national product (GNP) reaches us through some form of retailing.

To get into retailing is easy. To be forced out is just as easy. Consequently, to survive in retailing a company must do a satisfactory job in its primary role - catering to the consumer - and in its secondary role -

serving producers and wholesalers. This dual responsibility is both the justification for retailing and the key to success in retailing.

3.5 RETAILING'S PLACE IN THE MARKETING CHANNEL

Distribution is one of the most important concerns of marketers today. There would be little economic utility and even less satisfaction if manufacturers created new items but gave no thought about how to get them to the consumer. In an industrial world, where people are no longer self-sufficient, the key to success in having the goods in the right place at the right time. If a marketing system works well, it also provides for the four basic utilities isolated by economists: time, place, possession, and form. In other words, the system arranges for producing and having goods available when and where they are wanted, that is, in retail stores. The completed retail sales transaction then provides possession utility.

Are retailers always involved as goods move from manufacturer to user? There is no single answer to this question because retailers and other engaged in retailing exist at every level of the marketing channel and are therefore not always in the same channel position. For example, although the route traveled by a product may usually be through a traditional marketing channel, there is always the possibility of buying it direct from a wholesaler or manufacturer.

A firm does not have to be a retailer by definition in order to engage in retailing. Even though the largest percentage of consumer goods is marketed through the retail sector, many other firms throughout the channel engage in the functions traditionally performed by retailers.

3.6 FUNCTIONS PERFORMED BY RETAILERS

Retailers undertake business functions or activities that increase the value of the products and services they sell to consumers. These functions are:

1. providing an assortment of products and services.

2. breaking bulk - offering products in small quantities tailored to the consumption pattern of individual consumers and households.
3. storing products (holding inventory) so that consumers can buy products when they want them and in the quantities they want.
4. providing services to improve the ease with which consumers can purchase and use products.

Offering Assortments

Manufacturers specialize in producing specific types of products. If each of these manufacturers had its own stores that only sold its own products, consumers would have to go many different stores to buy groceries to prepare a single meal.

Retailers offer an assortment of products and services to their customers. By offering an assortment, retailers enable their customers to choose from a wide selection of brands, designs, sizes, colors, and prices in one location.

All retailers offer assortments of products, but they specialize in the assortments they offer. Supermarkets provide assortments of food, health and beauty aids and household products. Most consumers are well aware of the product assortments retailers offer.

Breaking Bulk

To reduce transportation costs, manufacturers and wholesalers typically ship cases of frozen dinners or cartons of blouses to retailers, and then the retailers provide the products in smaller quantities to meet consumer needs.

Storing Products

A major function of retailers is to keep inventory so that products will be available when consumers want them. Thus, consumer can keep a much smaller inventory of products, such as a tube of tooth paste or a half-

gallon of milk, at home because they know the retailers will have the products available when they need more.

By maintaining an inventory, retailers provide a benefit to consumers – they reduce the consumer's cost of storing products. First, the investment to store products ties up the consumers' money that could be put in a bank account and earn interest, or put to other use. Second, the products can be damaged or may spoil while they are being stored.

Providing Services

Retailers also add value to their merchandise by providing a variety of services. They offer credit so that consumers can have a product now and pay for it in the future. They display products so that consumers can see and test them before making a purchase. Retailers may have salespeople available to answer questions and provide additional information about the products. Some other retailers services include home delivery, gift wrapping, warranty coverage, repairs, alternations, and unit pricing information for making comparisons between brands.

Check Your Progress Exercise 1

1. What are channels of distribution?

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2. What is retailing?

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3. What do retailers do?

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3.7 CLASSIFICATIONS OF RETAILING

Broadly, retailing is classified into store retailing and non store retailing. Although most retailing is done in retail stores, in recent years non-store retailing has grown tremendously.

3.7.1 Store Retailing

Retail stores come in all shapes and sizes. They can be classified by one or more several characteristics like amount of service, product line, relative prices, control of outlets, and store cluster.

i) **Retailers Classified by Amount of Service**

Different products require different amount of service and customer service, and customer service preference vary.

- a) *Self-service retailers:* in such retailer stores, customers are willing to perform their own "locate-compare-select" process to save money. Self-service is the basis of discount operations and typically is used by sellers of convenience goods (such as supermarkets) and nationally branded, fast moving shopping goods (such as catalog show rooms).
- b) *Limited service retailers:* these type of retailers provide more sales assistance because they carry more shopping goods about which customers need information. Their operating costs are higher resulting from higher process.
- c) *Full service retailers:* sales people assist customers in every phase of the shopping process. They carry usually more specialty goods for which customers like to be "waited on". They provide more liberal return policies, various credit plans, free delivery, home serving, and extras such as lounges and restaurants. More services result in much higher operating costs, which are passed along to customers as premium price.

ii) Retailers Classified by Product Line

Retailers can also be classified by the length and breadth of their product assortment.

a) *Specialty stores*: these retail stores carry a narrow product line with deep assortment within that line (i.e., a number of product items). Specialty stores should not be confused with specialty goods. In a sense, specialty stores may carry any category of consumer goods, not just specialty goods. Specialty stores can be classified further by the narrowness of their product lines. For example:

- a clothing store is a single line store
- men's clothing store is a limited line store
- men's custom shirt store is a super specialty store.

b) *Department stores*: department stores are retailers that carry a wide variety and deep assortment, offer considerable customer services, and are organized into separate departments for displaying merchandise.

A department store is organized into departments selling men's, women's, and children's clothing and accessories; home furnishings and furniture; toys and games, consumer electronics such as TVs, VCRs, and stereos; and kitchen ware and small appliances.

Each department within the store has a specific selling space allocated to it, a cash register to transact and record sales, and sales people to assist customers. The department store often resembles a collection of specialty shops.

Department stores are often looked to as the retailing leaders. They usually lead in customer services – including credit, merchandise return, delivery, fashion shows and Christmas displays. They also are leaders because of their size.

- c) *Supermarkets*: they are large stores specialized in groceries with self service and wide assortments. Supermarkets introduced self-service, provided a very broad product assortment in large stores, and emphasized low price by reducing high cost services. Profits came from large volume of sales and not from high markups.

Supermarkets offer few customer services. Most of them emphasize prices. However, nowadays, they are improving their facilities and services to attract more customers. Typical improvements are better locations, improved décor, longer store hours, check cashing, delivery and even child care centers.

- d) *Convenience stores*: provide a limited assortment of merchandise at a convenient location and time in a neighborhood.

Convenience stores provide an opportunity for consumers to make fill-in purchases quickly, without having to search through a large store and wait in long checkout lines. Due to their small size and high turnover, convenience stores typically receive deliveries every day.

Since the principal benefit provided by convenience stores is convenience, they only have to offer a limited assortment and variety and can charge higher prices than supermarkets.

- e) *Superstores, combination stores and hypermarkets*: they differ from conventional supermarkets by size and assortment. They are larger than the conventional supermarkets.

- *Superstores*: are larger versions of the supermarket. They are almost twice the size of regular supermarkets and carry a large assortment of routinely purchased food and non-food items. They offer such services as dry cleaning, post offices, photo finishing, check cashing, bill paying, lunch counters, car care and pet care.

- Combination stores: are usually even larger than superstores. They are combined food and drug stores. They are combined food and drug stores. They offer more groceries and non-foods than a supermarket. Some combination stores are joint ventures between supermarkets and drug chains.
- Hyper stores: are even bigger than combination stores. They combine supermarket, discount, and warehouse retailing. They carry more than just routinely purchased goods, also selling furniture, appliances, clothing and many other things.

f) *Service retailing:* service businesses are those businesses whose "product line" is actually a service. There is considerable growth in service retailing. Many organizations that offer services to consumers – such as banks, hospitals, health spas, doctors, legal clinics, and universities – traditionally have not considered themselves as retailers. Due to increased competition, these organizations are adopting retailing principles to attract customers and satisfy their needs.

Some service retailers provide services in the customer's home, while others provide services in an office, often located in a strip shopping center.

iii) Retailers Classified by Relative Prices

Retailers also can be classified according to the prices they charge. Most retailers charge regular prices and normal quality goods and customer service. Some offer higher quality goods and services at higher prices.

- a) *Discount stores:* discount stores sell standard merchandise at lower prices by accepting lower margins and selling higher

volume. A true discount store regularly sells its merchandise at lower prices, offering mostly national brands, not inferior goods.

- b) *Off-price retailers:* off-price retailers buy less than regular wholesale prices and sell at less than retail. They tend to carry a changing and unstable collection of higher-quality merchandise, often-leftover goods, overruns, and irregulars obtained at reduced price from manufacturers or other retailers.

There are three main types of off-price retailers. Namely: factory outlets, independents and warehouse clubs.

Factory outlets: are off-price operations that are owned and operated by manufacturers and they normally carry the manufacturer's surplus, discontinued, or irregular goods.

Independents: are either owned and run by entrepreneurs or are divisions of large retail corporations.

Warehouse clubs (wholesale clubs): sell a limited selection of brand name grocery items, appliances, clothing and other goods at deep discounts to members who pay annual membership fees.

- c) *Catalog showrooms:* catalog showrooms sell a wide selection of high-mark up, fast moving, brand name goods at discount prices by placing a complete catalog and a number of sample items in a showroom and the remaining inventory in an attached warehouse.

They offer a broad but shallow assortment of merchandise, low prices, and few customer services. They stress selected product lines, such as cameras, consumer electronics, jewelry, sporting goods, and gift items. Shoppers examine the samples and catalogs available in the showroom or they may have already received a catalog in the mail.

iv) Retailers Classified by Control of Outlets

- a) *Corporate chains/chain stores:* chain stores are two or more outlets that are commonly owned and controlled, have central buying and merchandising, and sell similar lines of merchandise. They appear in all types of retailing, but they are strongest in department stores, variety stores, food stores, drugstores, shoe stores, and women's clothing stores.

They achieve economies of scale through central buying for different stores, which allows them to take advantage of quantity discounts. They also have advantages in promotion and management – spreading the costs to many stores.

- b) *Voluntary chains and retailer cooperatives:* the growth of corporate chains has encouraged the development of both voluntary chains and cooperative chains.

Voluntary chains: are wholesaler – sponsored group of independent retailers that engage in-group buying and common merchandising. The wholesaler sponsor often provides training programs, computer and accounting assistance.

Cooperative chains: are retailer – sponsored groups formed by independent retailers to run their own buying organization and conduct joint promotion effort.

- c) *Franchise:* is a contractual association between a manufacturer, wholesaler, or service organization (a franchiser) and independent business people (franchisees) who buy the right to own and operate one or more units in the franchise system.

Franchising is based on some unique product or service, on a method of doing business, or on the trade name, goodwill, or patent that the franchiser has developed the franchise benefit from the experience, buying power and the image of the

franchiser (the parent company). In return, the franchisee signs a contract to pay fees and commissions – and to strictly follow the franchiser rules.

- d) *Merchandising conglomerate*: they are corporations that combine several different retailing forms under central ownership and share some distribution and management functions. Diversified retailing provides superior management systems and economies that benefit all the separate retail operations.

v) Retailers Classified by Type of Store Cluster

Most stores today cluster together to increase their customer pulling power and to give consumers the convenience of one-stop shopping. The main types of store cluster are central business district and shopping centers.

- a) *Central business district*: they are retail cluster with department stores, specialty stores, banks, and movie theaters. They are usually located in down towns.
- b) *Shopping centers*: they are groups of retail businesses planned, developed, owned and managed as a unit.
 - Regional shopping centers: the largest shopping centers containing between 40 and 100 stores attracting customers from wide area.
 - Community shopping centers: contain 15 and 50 retail stores. They normally contain a branch of a department store, supermarket, specialty stores, and sometimes a bank.
 - Neighborhood shopping centers: generally contain 5 – 15 stores. They are close and convenient for consumers. They usually contain a supermarket, perhaps a discount store and several service stores dry cleaner, self-service laundry, drugstore, video rental outlet, barber or beauty shop.

3.7.2 Non-Store Retailing

Although a large majority of retail transactions are made in store, a growing volume of sales is taking place away from stores. Retailing activities resulting in transactions that occur away from a retail store are termed non-store retailing. Non-store retailing includes direct selling, telemarketing, automatic vending and direct marketing. Each type may be used by producers and/or retailers.

i) Direct Selling

Direct selling is a personal contact between a sales person and a consumer away from retail store. The two kinds of direct selling are door to door and party plan.

- a) *Door to door*: this means going directly to the consumers' home. It gives consumers the opportunity to buy at home or another convenient non store location. However, with the changing roles of women i.e., women now working outside home, direct selling firms find new ways of making contract with prospective customers. As the result office to office and house-sales parties appear in the place of door to door retailing.
- b) *Party Plan/Home Sales Parties*: in this plan, a host invites some friend to a party and will make a sales presentation. This creates a more favorable selling conditions than door to door as guest get to shop in a friendly, social atmosphere.

Direct selling provides the most aggressive form of retail promotion for the seller as well as the chance to demonstrate a product in the shopper's (rather than the seller's) environment. The drawback is that direct selling is the most expensive form of retailing due to higher costs for sales commission. This resulted in higher prices.

ii) Telemarketing

Sometimes called telephone selling, telemarketing refers to a sales person initiating contract with a shopper and also closing a sale over the telephone. It may rely on prospects who have requested information from the company or whose demographics match those of the firm's target market.

Many products that can be bought without being seen are sold over the telephone. Examples are magazine subscriptions, credit-card-membership etc.

Telemarketing allows customers to shop at house-usually placing order by telephone and charging the purchase to a credit card. Typically, catalogs let customers see the offerings. This can be real convenience to customers especially if desired products are not available at local stores.

iii) Automatic Vending

Automatic vending is selling and delivering products through vending machines. This type of retailing involves no personal contact between the buyer and seller.

Most products sold by automatic vending are convenience oriented or are purchased on impulse. They are usually well known brands with high rate of turnover. And the bulk of automatic vending sales has come from the "4 C's": Cold drinks, coffee, candy, and cigarettes. They are also used to sell good newspapers, food and snacks, cosmetics, audio tapes and even shoe shining services.

Vending machines are found everywhere in factories, offices, lobbies, retail stores, gasoline stations, airports, and train and bus terminals. However, automatic vending machines are expensive to buy, stock and repair relative to the volume they sell. And therefore prices of vended goods are higher.

iv) Direct Marketing

Direct marketing through various advertising media that interact directly with consumers, generally calling for the consumer to make a direct response. It involves the use of non-personal media to contact customers who, in turn, purchase products without visiting a retail store.

To contact consumers, direct marketers use one or more of the following media, radio, TV, newspapers, magazines, catalogs, and mailing (direct mail) and computers.

Direct marketing allows sellers to focus efficiently on mini markets with offers that better match specific consumer needs. It provides many benefits to consumers as well. It saves them time, and it introduces them to new life style and a larger selection of goods. In general, direct marketing allows great selectivity to markets and provides convenient shopping for customers.

The major types of direct marketing are direct mail, catalog retailing and on line shopping.

- a) *Direct Mail*: companies mail consumers letters, brochures, and even product sample, and ask that orders be placed by mail.
- b) *Catalog retailing*: companies mail catalog to consumers or make them available at retail stores.
- c) *On line shopping*: shopping through interactive on line computer service two way systems that link consumers with sellers electronically. These services create computerized catalogs of products and services which enable consumers compare the brands, then order one using a charge card all with out leaving home.

Check Your Progress Exercise 2

1. What is meant by non-store retailing?

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2. Identify retailers classified by product line.

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3.8 RETAILER MARKETING DECISIONS

Retail marketing decisions in the area of target market, product assortment and services, price, promotion and place are discussed in the following paragraphs.

Target Market Decisions

A retailer's most important decision concerns the target market. Until the target market is defined and profiled, the retailer cannot make consistent decisions on product assortment, store décor, advertising messages and media, price levels, and so on. Some stores are able to define their target market quite well. Many retailers, however, do not clarify their target market or are trying to satisfy too many markets, satisfying none of them well.

A retailer should carry out periodic market research to check that it is satisfying its target customers.

Product Assortment And Services

Retailers have to decide on three major "product" variables: products assortment, service mix, and store atmosphere. The retailer's product

assortment must match the shopping expectations of the target market. In fact, it becomes a key element in the competitive battle among similar retailers. The retailer has to decide on product assortment width (narrow or wide) and depth (shallow or deep). Another product assortment dimension is the quality of the goods. The customer is interested not only in the range of choice but also in the quality of the product.

Retailers must also decide on the services mix to offer customers. The old "mom and pop" grocery stores offered home delivery, credit, and conversation services that today's supermarkets have completely eliminated. Some of the major services that full service retailers can offer. The services mix is one of the key tools of non price competition for differentiating one store from another.

The store's atmosphere is a third element in its product arsenal. Every store has a "feel", one store is dirty, another is charming, a third is palatial, a fourth is somber. The store must embody a planned atmosphere that suits the target market and leans them toward purchase. A funeral parlor should be quiet, somber, and peaceful, and a discothque should be bright, loud, and vibrating. The atmosphere is designed by creative people who know how to combine visual, aural, olfactory, and tactile stimuli to achieve the desired effect.

Price Decision

The retailers prices are a key competitive factor and reflect the quality of goods carried and services offered. The cost of merchandise is the basis for their pricing, and their ability to buy intelligently is a key ingredient in successful retailing. Retailers can often make as much money through smart buying as through smart selling. Beyond this, they must price carefully in a number of other ways.

Promotion Decisions

Retailer use the normal promotional tools – advertising, personal selling, sales promotion, and publicity – to reach consumers. Retailers advertise in newspapers, magazines, radio, and television. The advertising is occasionally supplemented by hand-delivered circulars and direct-mail pieces. Personal selling requires careful training of the sales people in how to greet customers, meet their needs, and handle the doubts and complaints. Sales promotion may take the form of in store demonstrations, trading stamps, grand prizes, and visiting celebrities. Publicity is always available to retailers who have something interesting to say.

Place Decision

The retailer's choice of location is a key competitive factor in its ability to attract customers. For example, customers primarily choose a bank that is nearest to them. The problem breaks down into selecting regions of the country in which to open stores, then particular cities, and then particular sites.

Large retailers must wrestle with the problem of whether to locate several small stores in many locations or larger stores in fewer locations. Generally speaking, the retailer should locate enough stores in each city to gain visibility and distribution economies. The larger the individual stores, the greater their trading area to reach. Firms use a variety of methods to assess locations, including traffic counts, surveys of consumers shopping habits, analysis of competitive locations, and so on.

3.9 THE FUTURE OF RETAILING

1. *New Retail Forms: Shortening Retail Lifecycles* new retail forms continue to emerge to meet new situations and consumer needs but the lifecycle of new retail forms is getting shorter.

Many retailing innovations are partially explained by the wheel of retailing concept. According to this concept many new types of retailing forms begin as low margin, low price, low status operations. They challenge established retailers that have become "fat" by letting their costs and margins increase. The new retailers loss increase forcing them to increase their price. The wheel of retailing concept seems to explain the initial success and the later troubles of department stores, supermarkets, discount stores and the recent success of the price retailers.

2. *Growth of Non Store Retailing:* although most retailing still takes place the old fashioned way across countries in store. Consumers now have an array of alternative including mail order, television, phone and on line shopping. Such advance may threaten some traditional retailers. They offer exciting opportunities for others. Most store retailers are now actively exploring direct retailing channels.
3. *Increasing Inter Type Competition:* today's retailers increasingly face competition from many different forms of retailers. The competition between chain superstores and small independently owned store has become particularly heated. Because of their bulk buying power and high sales volume, chains can buy margins. The arrival of super stores can quickly force near by independents out of business.
4. *The Risk of Mega Retailers:* the rise of huge mass merchandisers and specialty super stores, the formation of vertical marketing systems and buying alliances and a rash of retail mergers and acquisitions have created a core of super power mega retailers. Through their superior information systems and buying power, these giant retailers are able to offer better merchandise selection goods and services and strong price savings to customers.

The mega retailers also are shifting the balance of power between retailers and producers. A relative handful of retailers now control access to enormous numbers of consumers giving them the upper hand in their dealing with manufacturers.

5. *Growing importance of retail technology:* retail technologies are becoming critically important as competitive tools. Progressive retailers are using computer to produce better forecasts, control inventory costs, order electronically from suppliers, and send e-mail between stores and even sell to customers within a store.
6. *Global Expansion of Major Retailers:* retailers with unique formats and strong brand positioning are increasingly moving into other countries. Many are expanding internationally to escape mature and saturated home markets.
7. *Retail Stores as "Communist" or "Hangouts":* with the rise in the number of people living alone, working at home or living in isolated, there has been resurgence of establishments that regardless of the product or service they offer, also provide a place for people to get together.

3.10 SUMMARY

Retailers are the most visible and accessible channel members to consumers. They are an important link in the marketing channels because they are both marketers and customers of producers and wholesalers.

Retailing includes all activities directly related to the sale of goods and services to the ultimate consumer for personal, non business use. While most retailing is done through retail stores, retailing may be done by any institution. Any firm manufacturer, wholesaler or retail store – that sells something to ultimate consumers for their non-business use is making a retail sale.

Retailers play two important roles. Namely: primary role – catering to the consumer – and secondary role serving producers and wholesalers. This dual responsibility is both the justification for retailing and the key to success in retailing.

Retailers perform important business functions. The major functions are offering assortments, breaking bulk, storing products and providing services.

Generally, retailing is classified into store retailing and non store retailing. Store retailing is done in retail stores while non-store retailing refers to retailing activities resulting in transactions that occur away from a retail store.

Retailing outlets can be classified along various dimensions. Like retail stores classified by amount of service, by product line, by relative prices, by control of outlets and by type of store cluster. Non-store retailing includes direct selling, telemarketing, automatic vending and direct marketing.

Retail marketing decisions are made in the area of target market, product assortment and services, price, promotion and place.

The future of retailing is characterized by new retail forms, growth of non store retailing, increasing intertype competition, the risk of mega retailers, growing importance of retail technology, global expansion of major retailers, and retail stores as "communists" or "hangouts".

3.11 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Exercise 1

1. Channels of distribution are the routes or paths that products follow as they are bought and sold on their way to the final consumer or industrial user.
2. Retailing is the selling of goods and services individually or in small quantities directly to the consumer for personal, non-business use.
3. Retailers perform the following important functions
 - offering assortments
 - storing products
 - breaking bulk
 - providing services

Exercise 2

1. Non-store retailing refers to retailing activities resulting in transactions that occur away from a retail store.
2. Retailers classified by product line include specialty stores, department stores, supermarkets, convenience stores, super stores, combination stores, and hypermarkets.

3.12 MODEL EXAMINATION QUESTIONS

1. Comment on the statement, "one does not have to be a retailer by definition in order to engage in retailing".
2. Where in the channel of distribution does retailing fit?
3. Differentiate between store and non-store retailing.
4. Explain retailing outlets classified by amount of service provided.
5. What trends and developments are likely to characterize retailing in the future?
6. Compare and contrast the following types of retailers of what they offer customers.

a) Specialty store	c) Super store
b) Department store	d) Hyper markets

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UNIT 4: THE WHOLESALE MARKET AND WHOLESALING MIDDLEMEN

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- 4.0 Aims and Objectives
- 4.1 Introduction
- 4.2 Nature and Importance of Wholesaling
- 4.3 Functions Performed by Wholesalers
- 4.4 Types of Wholesalers
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- 4.5 Wholesaler Marketing Decisions
- 4.6 Organizations That Facilitate Wholesaling Functions

- 4.7 Trends in Wholesaling
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- 4.9 Answers to Check Your Progress Exercises
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4.0 AIMS AND OBJECTIVES

The purpose of this unit is to discuss the wholesale market and wholesaling middlemen. After completing this unit, you will be able to

- explain the nature and importance of wholesaling
- describe the functions performed by wholesalers
- discuss the various types of wholesalers
- understand wholesaler marketing decisions
- know the organizations that facilitate wholesaling functions
- understand trends in wholesaling.

4.1 INTRODUCTION

Wholesalers are intermediaries used in marketing channels. They perform important marketing functions for the manufacturers and retailers. Like other intermediaries in a distribution channel, wholesalers take over some of the burden of marketing from the manufacturers. They are engaged in transactional, logistical, and facilitating functions.

Wholesalers are categorized into various types. Some take title to the goods they handle, whereas some others do not actually take title to the products they deal with. Rather, they do actively assist in the transfer of title.

Wholesalers are those individuals or institutions that are primarily engaged in wholesaling activities. The only real criterion that wholesalers

have to qualify is their purpose for buying. Broadly viewed, sales made by one manufacturer to another are wholesale transactions, and the selling manufacturer is engaged in wholesaling. However, here we are concerned with companies that are engaged primarily in wholesaling.

4.2 NATURE AND IMPORTANCE OF WHOLESALING

Wholesaling includes all activities involved in selling goods or services to those who buy for resale or business use. It excludes manufacturers and farmers because they are engaged primarily in production, and it excludes retailers.

Wholesalers (also called distributors) differ from retailers in a number of ways. First, wholesalers pay less attention to promotion, atmosphere, and location because they are dealing with business customers rather than final consumers. Second, wholesale transactions are usually larger than retail transactions, and wholesalers usually cover a larger trade area than retailers. Third, the government deals with wholesalers and retailers differently in regard to legal regulation and taxes.

Why are wholesalers used at all? Manufacturers could by pass them and sell directly to retailers or final consumers. The answer lies in several efficiencies that wholesalers bring about. First, small manufacturers with limited financial resources cannot afford to develop direct selling organizations. Second, even manufacturers with sufficient capital might prefer to use their funds to expand production rather than carry out wholesaling activities. Third, wholesalers are likely to be more efficient at wholesaling because of their scale of operation, their wider number of customer contacts, and their specialized skills. Fourth, retailers who carry many lines often prefer to buy assortments from a wholesaler rather than buy directly from each manufacturer.

4.3 FUNCTIONS PERFORMED BY WHOLESALERS

Wholesalers perform the following important functions.

- i) *Selling and Promoting:* wholesalers provide a sales force enabling manufacturers to reach many small-business customers at a relatively low cost. The wholesaler has more contracts and is often more trusted by the buyer than is the distant manufacturer.
- ii) *Buying and Assortment Building:* wholesalers are able to select items and build assortments needed by their customers, thus saving the customers considerable work.
- iii) *Bulk Breaking:* wholesalers achieve savings for their customers through buying in huge quantities and breaking the bulk into smaller units.
- iv) *Warehousing:* wholesalers hold inventories, there by reducing the inventory costs and risks to suppliers and customers.
- v) *Transportation:* wholesalers provide quicker delivery to buyers because they are closer than the manufacturer.
- vi) *Financing:* wholesalers finance their customers by granting credit, and they finance their suppliers by ordering early and paying their bills on time.
- vii) *Risk Bearing:* wholesalers absorb some risk by taking title and bearing the cost of theft, damage, spoilage, and obsolescence.
- viii) *Market Information:* wholesalers supply information to their suppliers and customers regarding competitors' activities, new products, price development, and so on.
- ix) *Management Services and Counseling:* wholesalers often help retailers improve their operations by training their sales clerks, helping with stores' layouts and displays, and setting up accounting and inventory control systems. They may help their industrial customers by offering training and technical services.

4.4 TYPES OF WHOLESALERS

Wholesalers vary greatly in products they carry, markets to which they sell and method of operation. Accordingly wholesalers can be classified as merchant wholesalers, agent wholesaling middlemen (brokers and agents), and manufacturers' sales facilities (sales branches and offices).

4.4.1 Merchant Wholesalers

Merchant wholesalers are independently owned businesses that take title to the merchandise they handle. In different trades they are called jobbers, distributors, or mill supply houses. Merchant wholesalers can be sub classified into full service wholesalers and limited service wholesalers.

Full Service Wholesalers

Full-service wholesalers provide such services as carrying stock, maintaining a sales force, offering credit, making deliveries, and providing management assistance. They include two types: wholesale merchants and industrial distributors.

Wholesale Merchants: sell primarily to retailers and provide a full range of services. General merchandise wholesalers carry several merchandise lines while general line wholesalers carry out one or two lines in greater depth. Specialty wholesalers specialize in carrying only part of a line. (Examples are healthfood wholesalers, seafood wholesalers, and so on).

Industrial Distributors: are merchant wholesalers who sell to manufacturers rather than to retailers. They provide several services, such as carrying stock, offering credit, and providing delivery. They may carry a broad range of merchandise, a general line, or a specialty line. Industrial distributors may concentrate on such lines as MRO

items (Maintenance, Repair, and Operating suppliers), OEM items (Original Equipment Suppliers such as ball bearings, motors), or equipment (such as hand and power tools, fork trucks).

Limited Service Wholesalers

Limited service wholesalers offer fewer services to their suppliers and customers. There are several types.

Cash and Carry Wholesalers: have a limited line of fast moving goods and sell to small retailers for cash and normally do not deliver.

Truck Wholesalers: truck wholesalers perform a selling and delivery function primarily. They carry a limited line of semi perishable merchandise (such as milk, bread, snack foods), which they sell for cash as they make their rounds of supermarkets, small groceries, hospitals, restaurants, factory cafeterias, and hotels.

Drop Shippers: operate in bulk industries, such as coal, lumber, and heavy equipment. They do not carry inventory or handle the product. Upon receiving an order, they select a manufacturer, who ships the merchandise directly to the customer on the agreed terms and time of delivery. The drop shipper assumes title and risk from the time the order is accepted to its delivery to the customer.

Rack Jobbers: serve grocery and drug retailers, mostly in the area of non food items. They send delivery trucks to stores, and the delivery person sets up toys, paper backs, hardware items, health and beauty aids, and so on. They price the goods, keep them fresh, set up point of purchase displays, and keep inventory records. Rack jobbers sell on consignment, which means that they retain title to the goods and bill the retailers only for the goods sold to consumers. Thus they provide such services as delivery, shelving, inventory carrying, and financing.

They do little promotion because they carry many branded items that are highly advertised.

Producers' Cooperatives: are owned by farmer members and assemble farm produce to sell in local markets. Their profits are distributed to members at the end of the year. They often attempt to improve product quality and promote a co-op brand name.

Mail Order Wholesalers: send catalogs to retail, industrial, and institutional customers featuring jewelry, cosmetics, specialty foods, and other small items. Their main customers are businesses in small outlying areas. No sales force is maintained to call on customers. The order are fill and sent by mail, truck, or other efficient means of transportation.

4.4.2 Brokers and Agents

Brokers and agents differ from merchant wholesalers. They do not take title to goods, and they perform only a few functions. Their main function is to facilitate buying and selling, and for this they will earn a commission. They generally specialize by product line or customer types.

A) Brokers

The chief function of a broker is to bring buyers and sellers together and assist in negotiation. They are paid by the party who hired them. They do not carry inventory, get involved in financing, or assume risk. The most familiar examples are food brokers, real estate brokers, insurance brokers, and security brokers.

B) Agents

Agents represent either buyers or sellers on a more permanent basis. There are several types.

i) *Manufacturers' Agents:* represent two or more manufactures of complementary lines. They enter into a formal written

agreement with each manufacturer covering pricing policy, territories, order handling procedure, delivery service and warranties, and commission rates. They know each manufacturer's product line and use their wide contacts to sell the manufacturer's products. Manufacturers' agents are used in such lines as apparel, furniture, and electrical goods. Most manufacturers' agents are small businesses, with only a few employees, who are skilled salespeople. They are hired by small manufacturers who cannot afford to maintain their own sales forces and by large manufacturers who want to use agents to open new territories or to represent them in territories that cannot support full time salespeople.

- ii) *Selling Agents:* are given contractual authority to sell a manufacturer's entire output. The manufacturer either is not interested in the selling function or feels unqualified. The selling agent serves as a sales department and has significant influence over prices, terms, and conditions of sale. The selling agents are found in such product areas as textiles, industrial machinery and equipment, coal and coke, chemicals, and metals.
- iii) *Purchasing Agents:* generally have a long term relationship with buyers and purchases for them, often receiving, inspecting, warehousing, and shipping the merchandise to the buyers. One type consists of resident buyers in major apparel markets, who look for suitable lines of apparel that can be carried by small retailers located in small cities. They are knowledgeable and provide helpful market information to clients as well as obtaining the best goods and prices available.
- iv) *Commission Merchants or houses:* are agents who take physical possession of products and negotiate sales. Normally, they are not employed on a long-term basis. They are used most often in agricultural marketing by farmers who do not want to sell their own output and do not belong to producers' cooperatives. A commission

merchant would take a truck load of commodities to a central market, sell it for the best price, deduct a commission and expenses, and remit the balance to the producer.

4.4.3 Manufacturers' Branches and Offices

Unlike merchant wholesalers, agents and brokers, manufacturer's branches and offices are wholly owned extensions of the producer that perform wholesaling activities. Producers will assume wholesaling functions when there are no intermediaries to perform these activities, customers are few in number and geographically concentrated, or orders are large or require significant attention. Wholesaling activities performed by producers are conducted by means of a branch office or sales office. A manufacturer's branch office carries a producer's inventory, performs the functions of a full service wholesaler, and is an alternative to a merchant wholesaler. A manufacturer's sales office does not carry inventory, typically performs only a sales function, and serves as an alternative to agents and brokers.

Check Your Progress Exercise 1

1. What are the points of distinction between wholesalers and retailers?

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2. Why are wholesalers used?

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3. Name the three types (broad classes) of wholesalers.

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4.5 WHOLESALE MARKETING DECISIONS

Wholesalers-distributors have experienced mounting competitive pressures in recent years. They have faced new sources of competition, demanding customers, new technologies, and more direct buying programs by large industrial, institutional, and retail buyers. As a result, they have had to develop appropriate strategic responses. One major drive has been to increase asset productivity by managing better their inventories and receivables. And they have had to improve their strategic decisions on target markets, product assortment and services, pricing, promotion, and place.

i) Target Market Decision

Wholesalers need to define their target markets and not try to serve everyone. They can choose a target group of customers according to size criteria (e.g., only large retailers), type of customer (e.g., convenience food stores only), need for service (e.g., customers who need credit), or other criteria. Within the target group, they can identify the more profitable customers and design stronger offers and build better relationships with them. They can propose automatic reordering systems, set up management training and advisory systems, and even sponsor a voluntary chain. They can discourage less profitable customers by requiring larger orders or adding surcharges to smaller ones.

ii) Product Assortment and Services Decisions

The wholesalers "product" is their assortment. Wholesalers are under great pressure to carry a full line and maintain sufficient stock for immediate delivery. But this can kill profits. Wholesalers today are

reexamining how many lines to carry and are choosing to carry only the more profitable ones. They are grouping their items on an ABC basis, with A standing for the most profitable items and C for the least profitable. Inventory carrying levels are varied for the three groups. Wholesalers are also examining which services count most in building strong customer relationships and which ones should be dropped or changed for. The key is to find a distinct mix of services valued by their customers.

iii) Pricing Decisions

Wholesalers usually mark up the cost of goods by a conventional percentage, say 20%, to cover their expenses. Expenses may run 17% of the gross margin leaving a profit margin of approximately 3%. In grocery wholesaling, the average profit margin is often less than 2%. Wholesalers are beginning to experiment with new approaches to pricing. They might cut their margin on some lines in order to win important new customers. They will ask suppliers for a special price break when they can turn it into an opportunity to increase the suppliers sales.

iv) Promotion Decision

Wholesalers rely primarily on their sales force to achieve promotional objectives. Even here, most wholesalers see selling as a single salesperson talking to a single customer instead of a team effort to sell, build, and service major accounts. As for non-personal promotion, wholesalers would benefit from adopting some of the image making techniques used by retailers. They need to develop an overall promotion strategy involving trade advertising, sales promotion, and publicity. They also need to make greater use of suppliers promotion materials and programs.

v) Place Decision

Wholesalers typically located in low rent, low tax areas as retailers and put little money into their physical setting and offices. Often the materials handling systems and order processing systems lag behind the available technologies. To meet rising costs, progressive wholesalers have been making time and motion studies of materials handling procedures. The ultimate development is the automated warehouse. Orders are fed into a computer and items are picked up by mechanical devices and conveyed on a belt to the shipping platform, where they are assembled. Most wholesalers now use computers to carry out accounting, billing, inventory control, and forecasting.

4.6 ORGANIZATIONS THAT FACILITATE WHOLESALING FUNCTIONS

In addition to the three main categories of wholesalers that have been described, there are other highly specialized organizations that perform wholesaling functions. Certain facilitating organizations make it unnecessary for a manufacturer or retailer to utilize a wholesaling establishment. The following sections show ways in which typical wholesaling functions can be performed by such facilitating agencies.

i) Public Warehouses

Public warehouses serve as storage facilities. An organization rents space in a warehouse instead of constructing its own facilities or using a merchant wholesaler's storage services. Public warehouses also provide other wholesaling activities. Many warehouses order, deliver, collect accounts, and maintain display rooms where potential buyers can inspect products. A producer can place products in a bonded warehouse and use them as collateral for a loan.

ii) Field Warehouses

Field warehouses are producer controlled storage spaces that separate part of the inventory in to a secure area within the warehouse. A field warehouse manager takes control and becomes responsible for the products. This operation makes it possible for a seller to obtain a warehouse receipt that can be used as collateral for a loan.

iii) Finance Companies

Products can be owned by a finance company or a bank while wholesalers or retailers maintain physical possession. Automobile dealer often call this form of financing "floor planning", it allows them to maintain a large inventory of cars to give customers greater selection and increase sales.

iv) Transportation Companies

Rail, truck, air and other carriers help manufacturers and retailers transport products without aid of middlemen. For example, freight forwarders combine less than full shipments into standard full loads at savings to customers. Perhaps at a carload rate rather than a less than car load rate. United parcel service is an example of a freight forwarder that provides door-to-door service for small containers and packages.

v) Trade Shows and Trade Marts

Tradeshows and trade marts allow manufactures or wholesalers to exhibit products to potential buyers and, therefore, assist in the selling and buying functions. Trade shows offer both selling and non-selling benefits. On the selling side, they allow vendors to identify prospects; gain access to key decision makers in current or potential customer companies; disseminate facts about their products, services, and personnel; and actually sell products and service current accounts through contacts at the show. The non-selling benefits include opportunities to maintain the company image with competitors, customers and the industry and to gather information on competitor's products and price. Other important

marketing variables on which trade shows have a positive influence include maintaining or enhancing corporate morale, product testing, and product evaluation.

Tradeshows can permit direct buyer-seller interaction and may eliminate the need for agents. Trade marts are relatively permanent facilities that firms can rent to exhibit producers year round.

4.7 TRENDS IN WHOLESALING

Manufacturers always have the option of bypassing wholesalers or of replacing inefficient wholesalers with better ones. The distinction between wholesaling activities that can be performed by any business and the traditional wholesaling establishment is somewhat blurred. Manufacturers, retailers, and facilitating organizations perform wholesaling functions to bridge the gap between manufacturers and consumers. Wholesaling functions can be shifted or shared, but not eliminated. Wholesaling activities have to be performed by someone or by some institution.

i) Prominence Among Types of Wholesalers

Two kinds of shifts have been taking place in wholesaling activities. First, merchant wholesalers have increased while manufacturers' sales branches have declined. This shift indicates that merchant wholesalers have provided more efficient stocking operations than manufacturers could provide for themselves. (Exceptions to this pattern are seen in industries producing drugs, automobiles, hardware, machinery, and equipment). Second, the share of trade for manufacturers' sales offices has increased, while agents and brokers' shares have declined. Manufacturers' sales offices perform essentially the same wholesaling functions as agents and brokers; the shift is from one type of selling operation to another. This movement indicates that manufacturers' sales

offices have developed more effective selling methods than independent agents.

In reaction to the integrated wholesaling activities of large corporate chains owned by retailers, voluntary chain wholesalers have evolved and have become strong establishments in the food industry. Voluntary wholesale chains can be formed by independent retailers or independent wholesaler's. Through innovative wholesaling methods, small independent food retailers can operate as efficiently and effectively as large chains.

ii) Bypassing Wholesalers

There is a trend to bypass traditional wholesaling establishment when alternative channels offer advantages for retailers or manufactures. New factory outlet malls illustrate the desire of some manufacturers to sell directly to the public. The following environmental conditions favor circumvention of traditional wholesalers:

1. Selling directly to retailers and industrial users becomes more important as unit value, perishability, and the need for service and installation increase.
2. If the manufacturer is strong financially and has a long line of products, direct sales are more feasible.
3. When retailers or users make large scale purchases or when customers are concentrated, direct sales may be employed.

In general, there is a trend toward simplified marketing channels and fewer distribution points, with a corresponding opportunity for greater centralization and control of distribution. Many producers are opening retail stores to gain a larger share of the market by exposing their product lines to more consumers.

The nature of new types of wholesaling establishments that arise will depend on the changing mix of activities that retailers and producers

perform and on the innovative efforts of wholesalers to develop efficiency in the marketing channel. The trend toward larger retailers – super stores and the like – will provide opportunities as well as threats to wholesaling establishments. Opportunities will develop from the expanded product lines of these mass merchandisers. A merchant wholesaler of groceries may want to add other low-cost, high volume products that are sold in superstores. On the other hand, some limited function merchant wholesalers may not be needed. The volume of sales may eliminate the need for rack jobbers, for example, who usually handle slow moving products that are purchased in limited quantities. The future of independent wholesalers, agents, and brokers depends on their ability to delineate markets and provide desired services. Wholesalers with low cost of operations are the only ones that will do well.

Check Your Progress Exercise 2

1. What are the areas in which wholesalers have to improve their strategic decisions?

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2. Name the various organizations that facilitate wholesaling functions.

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4.8 SUMMARY

Wholesaling includes all the activities involved in selling goods or services to those who are buying for the purpose of resale or for business use.

The reasons as to why we need wholesalers include limited financial resources of manufacturers, preference of manufacturers to use their finance to expand production facilities that would otherwise be used to develop direct selling activities, efficiency of wholesalers at wholesaling and retailers' preference to buy assortments from wholesalers.

Wholesalers perform many functions, including selling and promoting, buying and an assortment building, bulk-breaking, warehousing, transporting, financing, risk bearing, supplying market information, and providing management services and advice.

Wholesalers fall into three categories. First, merchant wholesalers, take the possession of the goods. They include full service wholesalers (wholesale merchants, industrial distributors) and limited service wholesalers (cash and carry wholesalers, truck wholesalers, drop shippers, rack jobbers, producers' cooperatives and mail order wholesalers). Second, brokers and agents, do not take possession of the goods but are paid a commission for aiding buying and selling. Finally, manufacturers' sales branches and offices are sale facilities where wholesaling operations are conducted.

Wholesalers make strategic decisions on target markets, product assortment and services, pricing, promotion, and place.

Organizations that facilitate wholesaling functions include public warehouses, field warehouses, finance companies, transportation companies, trade shows and trade marts.

The future of wholesaling is characterized by prominence among types of wholesalers and a trend to bypass traditional wholesaling establishment.

4.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Exercise 1

1. The points of distinction between wholesalers and retailers are with reference to attention, volume of transaction, trade area coverage and governmental activities.
2. Wholesalers are used because of
 - limited financial resources of manufacturers
 - preference of manufacturers to use their finance to expand production facilities
 - efficiency of wholesalers at wholesaling functions
 - retailers' preference to buy assortments from wholesalers.
3. The three types of wholesalers are merchant wholesalers, brokers and agents, and manufacturers' sales branches and offices.

Exercise 2

1. The areas in which wholesalers have to improve their strategic decisions include target market decision, product assortment, and services decision, pricing decision, promotion decision and place decision.
2. The various organizations that facilitate wholesaling functions include public warehouses, field warehouses, finance companies, transportation companies, and trade shows and trade marts.

4.10 MODEL EXAMINATION QUESTIONS

1. Describe any four basic wholesaler functions.
2. Distinguish agents and brokers.
3. Define wholesaling and state the three major categories.
4. Wholesaling functions can be shifted to or assumed by any channel member other than wholesalers, but cannot be eliminated. Explain this statement.
5. What are the features that characterize the future of wholesaling?

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UNIT 5: DISTRIBUTION/MARKETING CHANNELS

Contents

- 5.0 Aims and Objectives
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- 5.2 Nature and Importance of Channels of Distribution
- 5.3 Marketing Channel Functions and Flows
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- 5.5 Channel Design Decisions
 - 5.5.1 Analyzing Service Output Levels Desired by Customers
 - 5.5.2 Establishing the Channel Objectives and Constraints
 - 5.5.3 Identifying the Major Channel Alternatives
 - 5.5.4 Evaluating the Major Channel Alternatives
- 5.6 Selecting Channels of Distribution

- 5.6.1 Major Channels of Distribution
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- 5.7 Distribution Channel Management
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5.0 AIMS AND OBJECTIVES

This unit focuses on selecting and managing distribution/marketing channels. After completing this unit, you will be able to:

- ***explain the nature and importance of channels of distribution***
- ***describe marketing channel functions and flows***
- ***recognize the number of channel levels***
- ***discuss channel design decisions***
- ***describe the issues involved in the selection of channel of distribution***
- ***understand distribution channel management***
- ***explain channel cooperation, conflict, and competition***
- ***know legal and ethical issues in channel relations.***

5.1 INTRODUCTION

Most producers do not sell their goods directly to the final users. Between them and the final users a host of marketing

intermediaries performing a variety of functions and bearing a variety of names (like retailers and wholesalers discussed in unit 3 and 4) are involved.

Distribution channels can be compared to a pipeline through which water flows from a source to terminus. Marketing channels make possible the flow of goods from a producer, through intermediaries, to a buyer.

Marketing channel decisions are among the most critical decisions facing management. The company's chosen channels intimately affect all the other marketing decisions like pricing and promotion.

Reaching prospective buyers, either directly or indirectly, is a prerequisite for successful marketing. At the same time buyers benefit from distribution systems used by firm.

This unit focuses on marketing channels of distribution and why they are important component in the marketing mix. It then shows how such channels benefit consumers and the sequence of firms that make up a marketing channel. Finally it describes factors that influence the choice and management of marketing channels, including channel conflict and legal restriction.

5.2 NATURE AND IMPORTANCE OF CHANNELS OF DISTRIBUTION

As defined in unit three-distribution channel (also called marketing channel or trade channel) is the route that products follow as they are bought and sold on their way to the final user.

Marketing channel consists of various intermediaries that perform important marketing functions.

The use of middlemen largely boils down to their superior efficiency in marketing goods widely available and accessible to target markets. Marketing intermediaries, through their contacts, experience, specialization, and scale of operation, offer the producer more than it can usually achieve on its own. The importance of intermediaries is made even clearer when we consider the functions they perform and the benefits they create for buyers. Few consumers appreciate the value of intermediaries, however, producers recognize that intermediaries make selling goods and services more efficient because they minimize the number of sales contacts necessary to reach a target market.

5.3 MARKETING CHANNELS FUNCTIONS AND FLOWS

A marketing channel performs the work of moving goods from producers to consumers. It overcomes the time, place, and possession gaps that separate goods and services from those who would use them. Members in the marketing channel perform a number of key functions and participate in the following marketing flows:

- Information: ***the collection and dissemination of marketing research information about potential and current customers, competitors, and other actors and forces in the marketing environment.***
- Promotion: ***the development and dissemination of persuasive communications about the offer designed to attract customers.***

- Negotiation: ***the attempt to reach final agreement on price and other terms so that transfer of ownership or possession can be effected.***
- Ordering: ***the backward communication of intentions to buy by the marketing channel members to the manufacturer.***
- Financing: ***the acquisition and allocation of funds required to finance inventories at different levels of the marketing channel.***
- Risk taking: ***the assumption of risks connected with carrying out the channel work.***
- Physical possession: ***the successive storage and movement of physical products from raw materials to the final goods.***
- Payment: ***buyers paying their bills through banks and other financial institutions to the sellers.***
- Title: ***the actual transfer of ownership from the organization or person to another.***

These functions and flows are listed in the normal order in which they arise between any two channel members. Some of these flows are forward flows (physical, title, and promotion): others are backward flows (ordering and payment); and still others move in both directions.

The question is not whether these functions need to be performed - they must be - but rather who is to perform them. All of the functions have three things in common: they use up scarce resources; they can often be performed better through specialization; and they are shiftable among channel members. To the extent that the manufacturer performs the functions, the manufacturer's costs go up, and its prices must be higher. When some functions are shifted to middle men, the producer's costs and prices are lower, but the middle men must add a charge to

cover their work. If the middle men are more efficient than the manufacturer, the prices faced by consumers should be lower. Consumers might decide to perform some of the functions themselves, in which case they should enjoy lower prices. The issue of who should perform various channel tasks is one of relative efficiency and effectiveness.

Marketing functions, then, are more basic than the institutions that at any given time perform them. Changes in channel institutions largely reflect the discovery of more efficient way to combine or separate economic functions that must be carried on to provide meaningful assortments of goods to target customers.

5.4 NUMBER OF CHANNEL LEVELS

Marketing channels can be characterized by the number of channel levels. Each middleman that perform work in bringing the product and its title closer to the final buyer constitutes a channel level. Since the producer and the final customer both perform work, they are part of every channel. We will use the number of intermediary levels to designate the length of a channel.

A zero level channel (also called a direct marketing channel) consists of a manufacturer selling directly to the final customer. The major ways of direct marketing are door to door, home parties, mail order, telemarketing, TV selling, and manufacturer owned stores.

A one level channel contains one selling intermediary, such as a retailer. A two level channel contains two intermediaries. In consumer markets, they are typically a wholesaler and a retailer. A three level channel contains three intermediaries.

Check Your Progress Exercise 1

1. Outline marketing channels functions.

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2. What is a channel length?

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5.5 CHANNEL DESIGN DECISIONS

We will now examine several channel decision problems facing manufacturers. In designing marketing channels, manufacturers have to struggle between what is ideal, what is feasible, and what is available. A new firm typically starts as a local operation selling in a limited market. Since it has limited capital, it usually uses existing middlemen. The number of middlemen in any local market is apt to be limited: a few manufacturer's sales agents, a few wholesalers, several established retailers, a few trucking companies, and a few warehouses. Deciding on the best channels might not be a problem. The problem might be to convince one or a few available middlemen to handle their line.

Designing a channel system calls for analyzing customer needs, establishing channel objectives, identifying the major channel alternatives, and evaluating them.

5.5.1 Analyzing Service Output Levels Desired by Customers

Understanding what, where, why, when, and how target customers buy is the first step in designing the marketing channel. The marketer must understand the service output levels desired by the target customers. Channels produce five service outputs:

- a) Lot Size: is the number of units that the marketing channel permits a typical customer to buy on a buying occasion. The smaller the lot size, the greater the service output level that the channel must provide.**
- b) Waiting Time: is the average time that customers of that channel wait for receipt of the goods. Customers normally prefer fast delivery channels. Faster service requires a greater service output level.**
- c) Spatial Convenience: expresses the degree to which the marketing channel makes it easy for customers to purchase the product. Spatial convenience is being further augmented by the use of direct marketing.**
- d) Product Variety: represents the assortment breadth provided by the marketing channel. Normally customers prefer greater assortment breadth because it increases the chance of exactly meeting their need.**
- e) Service Backup: represents the add on services (credit, delivery, installation, repairs) provided by the channel. The greater the service backup, the greater the work provided by the channel.**

The marketing channel designer must know the service outputs desired by the target customers. Providing increased levels of service outputs means increased costs for the channel and higher prices for customers. The success of discount stores indicates that many customers are willing to accept lower-service outputs when this translates into lower prices.

5.5.2 Establishing the Channel Objectives and Constraints

The channel objectives should be stated in terms of targeted service output levels. Usually, several segments can be identified

that desire differing service output levels. Effective channel planning requires determining which market segments to serve and the best channel to use in each case. Each producer develops its channel objectives in the face of several constraints.

Channel objectives vary with products characteristics. Perishable products require more direct marketing because of the dangers associated with delays and repeated handling. Bulky products, such as building materials or soft drinks, require channels that minimize the shopping distance and the number of handlings in the movement from producer to consumers. Non-standardized products, such as custom-built machinery and specialized business forms, are sold directly by company sales representatives because middlemen lack the requisite knowledge. Products requiring installation and/or maintenance services are usually sold and maintained by the company or exclusively franchised dealers. High unit value products are often sold through a company sales force rather than through middlemen.

Channels design must take into account the strengths and weaknesses of different types of intermediaries. For example, manufacturers' representatives are able to contact customers at a low cost per customer because the total cost is shared by several clients. But the selling effort per customer is less intense than if the company's sales representatives did the selling. Channel design is also influenced by the competitors' channels.

Channel design must adapt to the larger environment. When economic conditions are depressed, producers want to move their goods to market in the most economical way. This means using shorter channels and dispensing goods. Legal regulations and restrictions also affect channel design. The law looks unfavorably

upon channel arrangements that "may tend to substantially lessen competition or tend to create a monopoly."

5.5.3 Identified the Major Channel Alternatives

After a company has defined its target market and desired positioning, it should identify its channel alternatives. A channel alternative is described by three elements. Namely: the types of business intermediaries, the number of intermediaries, and the terms and responsibilities of each channel participant.

A. Types of Intermediaries

The firm needs to identify the types of intermediaries available to carry on its channel work.

B. Number of Intermediaries/Intensity of Distribution

The intensity of distribution refers to the number of middlemen to be employed at the wholesale and retail levels. Three degrees of distribution density exist: intensive, exclusive, and selective.

- i) Intensive distribution: utilizes as many outlets as possible and is especially appropriate for convenience goods and common raw materials.***
- ii) Exclusive distribution: is the extreme opposite of intensive distribution because only one retail outlet in a specified geographical area carries the firm's product. It is typically chosen for specialty products or services.***
- iii) Selective distribution: uses more than one outlet per market but less than all available outlets. This strategy gains good market coverage and gains better than average selling effort.***

C. Terms and Responsibilities of Channel Members

The producer must determine the conditions and responsibilities of the participating channel members. The main elements in the "trade relations mix" are price policies, conditions of sale, territorial rights, and specific services to be performed by each party.

- Price Policy calls for the producer to establish a price list and schedule of discounts. The middlemen must see these as equitable and sufficient.***
- Conditions of Sale refer to payment terms and producer guarantees. Most producers grant cash discounts to their distributors for early payment. Producers might also guarantee distributors against defective merchandise or price declines. A guarantee against price declines induces distributors to buy larger quantities.***

- Distributors' Territorial Rights **are another element in the trade-relations mix. Distributors want to know where the producer will enfranchise other distributors. They would also like to receive full credit for all sales taking place in their territory, whether or not they did the selling.**
- Mutual Services and Responsibilities **must be carefully spelled out, especially in franchised and exclusive agency channels.**

5.5.4 Evaluating the Major Channel Alternatives

Suppose a producer has identified several channel alternatives and wants to determine the best one. Each alternative needs to be evaluated against economic, control, and adaptive criteria.

A. Economic Criteria

Each channel alternative will produce a different levels of sales and costs. The first question is whether more sales will be produced through a company sales force or through a sales agency. Most marketing managers believe that a company sales force will sell more. Company sales representatives concentrate entirely on the company's products; they are better trained to sell the company's products. They are more aggressive because their future depends on the company's success; they are more successful because many customers prefer to deal directly with the company.

B. Control Criteria

Channel evaluation must be broadened to include control issues. Using a sales agency poses a control problem. A sales agency is an independent business firm seeking to maximize its profits. The agents may concentrate on the customers who buy the most, not

necessarily of the manufacturer's goods. Furthermore, the agents might not master the technical details of the company's product or handle its promotion materials effectively.

C. Adaptive Criteria

In order to develop a channel, the channel members must make some degree of commitment to each other for a specified period of time. Yet these commitments invariably lead to a decrease in the producer's ability to respond to a changing market place. In rapidly changing, volatile, or uncertain product markets, the producer needs to seek channels structures and policies that maximize control and ability to swiftly change marketing strategy.

5.6 SELECTING CHANNEL OF DISTRIBUTION

Most distribution channels include middlemen, but some do not. A channel consisting only of producer and final consumer, with no middlemen providing assistance is called direct distribution. In contrast, a channel of producer, final customer, and at least one level of middlemen represent indirect distribution. With indirect distribution a producer must determine the type(s) of middlemen that will best serve its needs. A wide range of options are available in selecting channels of distribution.

5.6.1 Major Channels of Distribution

All products whether they be consumer goods, industrial goods or services require a channel of distribution. Industrial channels tend to be shorter than consumer channels because of the small number of ultimate customers, the greater geographic concentration of industrial customers, and the greater complexity of the products, which require close producer customer liaison. Service channels also tend to be short because of the intangibility

of services and the need for personal contact between the service provider and consumer.

a) Distribution of Consumer Goods

Five channels are widely used in the marketing of consumer products. In each, the manufacturer also has the alternative of using sales branches or sales offices.

- **Producer → Consumer**

The shortest, simplest channel of distribution for consumer products is from the producer to the consumer, with no middlemen involved. The producer may sell from house to house or by mail.

- **Producer → Retailer → Consumer**

Many large retailers buy directly from manufacturers and agricultural producers.

- **Producer → Wholesaler → Retailer → Consumer**

If there is a "traditional" channel for consumer goods, this is it. Small retailers and small manufacturers by thousands find this channel the only economically feasible choice.

- **Producer → Agent → Retailer → Consumer**

Instead of using wholesaler, many producers prefer to use a manufacturers' agent or some other agent middleman to reach the retail market, specially large scale retailers. For example, a manufacturer of a glass cleaner selected a food broker to reach the grocery store market, including the large chains.

- **Producer → Agent → Wholesaler → Retailer → Consumer**

To reach small retailers, the producers mentioned in the preceding paragraph often use agent middlemen, who in turn call on wholesalers that sell to small stores.

b) Distribution of Industrial Goods

Four types of channels are widely used in reaching industrial users. Again, a manufacturer may use a sales branch or a sales office to reach the next institution in the channel.

- **Producer → Industrial User**

This direct channel accounts for a greater volume of industrial products than any other distribution structure. Manufacturers of large installations, such as airplanes, generators, and heating plants, usually sell directly to users.

- **Producer → Industrial Distributor → User**

Producers of operating supplies and small accessory equipment frequently use industrial distributors to reach their markets. Manufacturers of building material and air conditioning equipment are two examples of firms that make heavy use of the industrial distributor.

- **Producer → Agent → User**

Firms without their own marketing department find this a desirable channel. Also, a company that wants to introduce a new product or enter a new market may prefer to use agents rather than its own sales force.

- **Producer → Agent → Industrial Distributor → User**

This channel is similar to the preceding one. It is used when, for some reason, it is not feasible to sell through agents directly to the industrial user. The unit sale may be too small for direct selling. Or decentralized inventory may be needed

to supply users rapidly in which case the storage services of an industrial distributor are required.

c) Service Channel

Distribution channels for services are usually short, either direct or by using an agent. Since stocks are not held, the role of the wholesaler, retailer or industrial distributor does not apply. There are two alternatives whether they be consumer or industrial customers.

- Service Provider → Consumer or Industrial Customer

The close personal relationships between service providers and customers often mean that service supply is direct. Examples include health care, office cleaning, accountancy, marketing research and law.

- Service Provider → Agent → Consumer or Industrial Customer

A channel intermediary for a service company usually takes the form of an agent. Agents are used when service provider is geographically distant from customers, and where it is not economical for the provider to establish their own sales team. Examples include insurance, travel, secretarial and theatrical agents

5.6.2 Factors Affecting Choice of Distribution Channels

Because a channel of distribution should be determined by customer buying patterns, the nature of the market is the key factor influencing management's choice of channels. Other major considerations are the product, the middlemen, and the company itself. Basically, when selecting its channels of distribution, a company should follow the criteria of the three C's - Channel

Control, Market Coverage, and a Cost that is consistent with the desired level of customer service.

a) Market Considerations

Perhaps the most obvious point to consider is whether the produce is intended for the consumer or industrial market. If it is going to the industrial market, of course retailers will not be included in the channel. In either case, other significant market variables should be considered.

- ***Number of potential customers: with relatively few potential customers, a manufacturer may use its own sales force to sell directly to consumers or industrial users. For a large number of customers, the manufacturer would more likely use middlemen. A related point is the number of different industries to which a firm sells. One company, marketing drilling equipment and supplies only to the oil industry, sold directly to users. A paper products manufacturer, on the other hand, made extensive use of industrial distributors to reach many different industries.***
- ***Geographic concentration of the market: direct sale to the textile or the garment manufacturing industry is feasible because most of the buyers are concentrated in a few geographic areas. Even in the case of a national market, some segments have a higher density rate than others. Sellers may establish sales branches in densely populated markets, but they would use middlemen in the less concentrated markets.***
- ***Order size: manufacturers would sell directly to retailers (like large grocery chains) because the larger order size and total volume of business make this channel economically***

desirable. The same manufacturer, would use wholesalers to reach small grocery stores whose order are usually too small to justify direct channel.

b) Product Consideration

- ***Unit value: the unit value of a product affects the amount of funds available for distribution. Thus, the lower the unit values, the longer, usually are the channels of distribution. However, when products of low unit value are sold in large quantities or are considered with other goods so that the total order is large, shorter channels may be economically feasible.***
- ***Perishability: products subject to physical or fashion perishability must be speeded through their channels. The channels are short.***
- ***Technical nature of a product: an industrial product that is highly technical is often distributed directly to industrial users. The producer's sales force must provide considerable presale and post sale service; wholesalers normally cannot do this.***

Consumer products of a technical nature provide a real distribution challenge for manufacturers. Ordinarily manufacturers cannot sell the goods directly to the consumer. As much as possible, manufacturers try to sell directly to retailers, but even then the servicing of the product often poses problems.

c) Middlemen considerations

- ***Service provided by middlemen: each producer should select middlemen that will provide those marketing services that the producer either is unable to provide or cannot economically perform.***

- **Availability of desired middlemen:** *the middlemen whom a producer desires may not be available. They may be carrying competitive products and may not wish to add another line.*
- **Attitude of middlemen toward manufacturers' policies:** *sometimes, manufacturers' choices of channels are limited because their marketing policies are not acceptable to certain types of middlemen. Some retailers or wholesalers, for example, are interested in carrying a line only if they can get an exclusive franchise in a territory.*

d) *Company considerations*

- **Financial resources:** *a financially strong company needs middlemen less than one that is financially weak. A business with adequate finances can establish its own sales force, grant credit, or warehouse its own products. A financially weak firm would have to use middlemen who could provide these services.*
- **Ability of management:** *channel decisions are affected by the marketing experience and ability of the firm's management. Many companies lacking marketing know how prefer to turn the distribution job over to middlemen.*
- **Desire for channel control:** *some producers establish short channels simply because they want to control the distribution of their products, even though the cost of the more direct channel may be higher. By controlling the channel, producers can achieve more aggressive promotion and better control both the freshness of merchandise stocks and the retail prices of their products.*
- **Services provided by seller:** *often producers' channel decisions are influenced by the marketing services they can provide in relation to those demanded by middlemen. For*

example, often a retail chain will not stock a given product unless it is pre sold through heavy manufacturer advertising.

5.7 DISTRIBUTION CHANNEL MANAGEMENT

A number of channel management issues must be addressed. These are the selection, motivation, training, evaluation of channel members, and managing conflict between manufacturers and other channel members.

a) Selection

For some producers (notably small companies) the distribution problem is not so much channel selection as channel acceptance. Selection then involves identifying candidates and developing selection criteria.

- Identifying sources: sources for identifying candidates include trade sources, reseller enquiries, customers of distributors, and the field sales force. Trade sources include trade associations, exhibitions and trade publications. Reseller enquiries show that the possible distributor is enthusiastic about the possibility of a link. Customers of distributors are a useful source since they can comment on their merits and limitations. Finally, if a producer already has a field sales force calling on intermediaries, sales people are in a good position to seek out possible new distributors in their own territory.*
- Developing selection criteria: common selection criteria include marketing, product and customer knowledge, market coverage, quality and size of the sales force (if applicable) reputation among customers, financial standing, the extent to which competitive and complementary products are*

carried, managerial competence and hunger for success, and the degree of enthusiasm for handling the producer's lines.

b) Motivation

Once selected, channel members need to be motivated to agree to act as a distributor, and allocate adequate commitment and resource to the producer's lines. The key to effective motivation is to understand the needs and problems of distributors since needs and motivations are linked. Possible motivators include financial rewards, territorial exclusivity, providing resource support and developing strong work relationships.

In short, management of independent distributors is best conducted in the context of informal partnerships. Producers should seek to develop strong relationships with their distributors based on a recognition of their performance and integrated planning and operations. For example, jointly determined sales targets could be used to motivate and evaluate sales people who might receive a bonus upon achievement.

c) Training

The need to train channel members obviously depends on their internal competences. Large market-supermarket chains, for example, may regard an invitation by a manufacturer to provide marketing training as an insult. However, many smaller distributors have been found to be weak on sales management, marketing, financial management, stock control and personnel management and may welcome producer initiatives on training. From the producer's perspective training can provide the necessary technical knowledge about a supplier company and it

products, and help to build a spirit of partnership and commitment.

d) Evaluation

The evaluation of channel members has an important bearing on distributor retention, training and motivation decisions. Evaluation provides the information necessary to decide which channel member to retain and which to drop.

Evaluation criteria include sales volume and value, profitability, level of stocks, quality and position of display, new accounts opened, selling and marketing capabilities, quality of service provided to customers, market information feedback, ability and willingness to deep commitments, attitudes, and personal capability.

e) Channel conflict

It is disagreement among marketing channel members on goals and roles-who should do what and for what rewards (this issue will be discussed in detail in the following topics).

Check Your Progress Exercise 2

- 1. Define density of distribution /intensity of distribution and state the three categories.**

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- 2. What are the criteria for evaluating the major channel alternatives?**

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3. *Identify the five possible distribution channels for consumer goods.*

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5.8 CHANNEL COOPERATION, CONFLICT, AND COMPETITION

No matter how well channels are designed and managed, there will be some conflict, if for no other reason than the interests of independent business entities don't always coincide. Here we examine three questions: what types of conflict arise in channel? What are the major causes of channel conflict? What can be done to resolve situations of conflict?

5.8.1 Types of Conflict and Competition

Channels conflict arises when one channel member believes another channel member is engaged in behavior that prevents it from achieving its goals. Three types of conflict can be identified. Namely: vertical conflict, horizontal conflict and multi-channel conflict.

Vertical conflict occurs between different levels in a marketing channel; for example, between a manufacturer and a wholesaler or retailer or between a wholesaler and a retailer. Three sources of vertical conflict are most common. First, conflict arises when a channel member by passes another member and sells or buys products direct. Second, disagreements over how profit margins are distributed among channel members produce conflict. A third conflict situation arises when

manufacturers believe wholesalers or retailers are not giving their products adequate attention.

Horizontal conflict occurs between intermediaries at the same level in a marketing channel, such as between two or more retailers or two or more wholesalers that handle the same manufacturer's brands. Two sources of horizontal conflict are most common. First, horizontal conflict arises when a manufacturer increases its distribution coverage in a geographical area. Second, dual distribution causes conflict when different types of retailers carry the same brands.

Multi-channel conflict exists when the manufacturer has established two or more channels that compete with each other in selling to the same market. Multi-channel conflict is likely to be especially intense when the members of one channel either get a lower price (based on larger volume purchases) or are willing to work with a lower margin.

5.8.2 Causes of Channel Conflict

It is important to distinguish the different causes that might produce channel conflict. Some causes are easy to resolve, others more difficult.

A major cause is goal incompatibility. For example, the manufacturer may want to achieve rapid market growth through a low price policy. The dealers, on the other hand, may prefer to work with high margins and pursue short run profitability. This is a difficult conflict to solve.

Sometimes the conflict arises from unclear roles and rights. Territory boundaries, credit for sales, and so forth are grounds for conflict. The conflict can also stem from differences in perception. The manufacturer may be optimistic about the near term economic outlook and want dealers to carry higher inventory. But the dealers may be pessimistic about the near term outlook.

The conflict might arise because of the great dependence of the middlemen on the manufacturer. Exclusive dealers, such as auto dealers, have their fortunes intimately affected by the product design and pricing decisions of the manufacturer. This creates a high potential for conflict.

5.8.3 Managing Channel Conflict

Conflict can have destructive effects on the workings of a marketing channel, so it is necessary to secure cooperation among channel members. One means is through a channel captain, a channel member that co-ordinates, directs and supports other channel members. Channel captains can be producers, wholesalers, or retailers. A firm becomes a channel captain because it is typically the channel member with the greatest power to influence the behavior of other members. Power can take four forms. First, **economic power** arises from the ability of a firm to reward or influence other members. **Expertise** is a second source of power over other channel members. Third, **identification** with a particular channel member may also create power for that channel member. Finally power can arise from the **legitimate right** of one channel member to dictate the behavior of other member.

Other than the role of channel captain in avoiding and resolving conflict, there are several ways to managing conflict.

- *Developing a partnership:* this calls for frequent interaction between producer and resellers to develop a spirit of mutual understanding and cooperation. Producers can help channel members with training, financial help and promotional support. Distributors, in turn, may agree to mutually agreed sales targets and provide extra sales resources. The objective is to build confidence in the manufacturer's products and relationships based on trust. When conflicts arise there is more chance they will be resolved in a spirit of cooperation. Organizing staff exchange

programmes can be useful in allowing each party to understand the problems and tensions of the other rather than animosity.

- *Training in conflict handling:* staffs who handle disputes need to be trained in negotiation and communication skills. They need to be able to handle high pressure conflict situations without resorting to emotion and blaming behavior. In stead, they should be able to handle such situations calmly and be able to handle concession analysis, in particular the identification of win-win situations. These are situations where both the producer and reseller benefit from an agreement.
- *Market partitioning:* to reduce or eliminate conflict from multiple distribution channels, producers can try to partition markets on some logical basis such as customer size or type. This can work if channel members accept the basis for the partitioning. Alternatively, different channels can be supplied with different product line.
- *Improving performance:* many conflicts occur because of genuine reasons. For example, poor delivery by manufacturers or inadequate sales effort by distributors can provoke frustration and anger. Rather than attempt to placate the aggrieved partner, the most effective solution is to improve performance so that the source of conflict disappears. This is the most effective way of dealing with such problems.
- *Channel ownership:* an effective but expensive way of resolving conflicting goals is to buy the other party. Since producer and channel member is under common ownership the common objective is to maximize joint profits. Conflicts can still occur but the dominant partner is in a position to resolve them quickly.
- *Coercion:* in some situations, conflict resolution may be dependent on coercion: one party forces compliance through the use of force. For example, producers can threaten to withdraw supply, deliver

late, or withdraw financial support; channel members, on the other hand, can threaten to delist the manufacturer's products, promote competitive products and develop own label-brands.

5.9 LEGAL AND ETHICAL ISSUES IN CHANNEL RELATIONS (AMERICAN CASE)

For the most part, companies are legally free to develop whatever channel arrangements suits them. In fact, the laws affecting channels seek to prevent the exclusionary tactics of companies that might keep other companies from using a desired channel. Of course, this means that the company must itself avoid using such exclusionary tactics. Most channel law deals with the mutual rights and duties of the channel members once they have formed a relationship.

- *Exclusive dealing*: many producers and wholesalers like to develop exclusive channels for their products. When the seller allows only certain outlets to carry its products, this strategy is called exclusive distribution. When the seller requires that these dealers not handle competitor's products, its strategy is called exclusive dealing. Both parties benefit from exclusive arrangements: the seller obtains more loyal and dependable outlets, and the dealers obtain a steady source of supply and stronger seller support. But exclusive arrangements exclude other producers from selling to these dealers. This situation brings exclusive dealing contracts under the scope of the Clayton act of 1914. They are legal as long as they do not substantially lessen competition or tend to create a monopoly and as long as both parties enter into the agreement voluntarily.
- *Exclusive territories*: exclusive dealing often includes exclusive territorial agreements. The producer may agree not to sell to other dealers in a given area, or the buyer may agree to sell only in its own territory. The first practice is normal under franchise systems

as a way to increase dealer enthusiasm and commitment. It is also perfectly legal-a seller has no legal obligation to sell through more outlets than it wishes. The second practice, where by the producer tries to keep a dealer from selling outside its territory, has become a major legal issue.

- *Tying agreements*: producers of a strong brand sometimes sell it to dealers only if the dealers will take some or all of the rest of the line. This is called full line forcing. Such tying agreements are not necessarily illegal, but they do violate the Clayton act if they tend to lessen competition substantially. The practice may prevent consumers from freely choosing among competing suppliers of these other brands.
- *Dealers' rights*: producers are free to select their dealers, but their right to terminate dealers is somewhat restricted. In general, sellers can drop dealers "for cause". But they cannot drop dealers if, for example, the dealers refuse to cooperate in a doubtful legal arrangement, such as exclusive dealing or tying agreements.

Check Your Progress Exercise 3

1. Define channel conflict.

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2. What are the causes of channel conflict?

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3. State the various ways by the help of which channel conflicts can be avoided and resolved.

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4. What is meant by "exclusive dealing"?

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5.10 SUMMARY

Marketing channels are the routes /paths that products follow as they are bought and sold on their way to the final users. They are either direct or indirect.

The most important channel functions and flows are information, promotion, negotiation, ordering, financing, risk taking, physical possession, payment, and title. These functions are more basic than the particular retail and wholesale institutions that may exist at any time.

Number of channel levels refers to the number intermediaries involved in the marketing channel. A zero level channel is a direct marketing channel with no intermediary.

Marketing channel decisions are among the most complex and challenging decisions facing the firm. Each channel system creates a different level of sales and costs.

Channel design calls for determining the service outputs (lot size, waiting time, spatial convenience, product variety, service backup), establishing the channel objectives and constraints, identifying the major channel alternatives (types and number of intermediaries, specifically intensive, exclusive, or selective distribution), and the channel terms and

responsibilities. Each channel alternative has to be evaluated according to economic, control, and adaptive criteria.

There are three major channels of distribution. Namely distribution channels for consumer goods, distribution channels for industrial goods, and service channel.

Factors affecting choice of distribution channels include market considerations, product considerations, middlemen considerations and company considerations. Basically when selecting its channels of distribution, a company should follow the criteria of the three C's - channel control, market coverage, and a cost that is consistent with the desired level of customer service.

Channel management calls for the selection, motivation, training and evaluation of channel members and managing conflict.

All channel systems have a potential for vertical, horizontal, and multi channel conflict arising from such sources as goal incompatibility, unclear roles and rights, differences in perception, and high dependence.

Managing channel conflicts can be sought through the channel captain. Other than the role of the channel captain, other ways of managing conflict include developing a partnership, training in conflict handling, market partitioning, improving performance, channel ownership and coercion.

5.11 ANSWER TO CHECK YOUR PROGRESS EXERCISES

Exercise 1

1. Marketing channel functions are information, promotion, negotiation, ordering, financing, risk taking, physical possession, payment and title.

2. Channel length is the number of channel levels in the marketing channel. In other words, it is the number of intermediaries involved in the marketing channel.

Exercise 2

1. Density of distribution/intensity of distribution refers to the number of intermediaries at a wholesale and retail levels. The three categories are intensive, exclusive and selective.
2. The criteria for evaluation of the major channel alternatives are economic, control and adaptive criteria.
3. The five possible distribution channels for consumer goods are:
 - Producer → Consumer
 - Producer → Retailer → Consumer
 - Producer → Wholesaler → Retailer → Consumer
 - Producer → Agent → Retailer → Consumer
 - Producer → Agent → Wholesaler → Retailer → Consumer

Exercise 3

1. Channel conflict is disagreement among marketing channel members on goals and roles who should do what and for what rewards.
2. The causes of channel conflict are goal incompatibility, unclear roles and rights, differences in perception, and great dependence.
3. The various ways through which conflicts can be avoided and resolved include developing a partnership, training in conflict handling, market partitioning, improving performance, channel ownership and coercion.
4. Exclusive dealing is a distribution strategy whereby the seller requires that dealers do not handle competitors' products.

5.12 MODEL EXAMINATION QUESTIONS

1. What type of channel conflict is likely to be caused by dual distribution, and what type of conflict can be reduced by direct distribution? Why?
2. Define vertical conflict, and state the three common sources.
3. Identify and describe the three criteria that a company should follow when selecting its channels of distribution.
4. Who is a channel captain? How does a channel member assume this status?
5. Briefly describe the criteria for the selection of channel members (middlemen).
6. What are the issues to be addressed in product considerations?

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