

# Managing Business Marketing Channels

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*The channel of distribution is the marketing manager's bridge to the market. Channel innovation represents a source of competitive advantage that separates market winners from market losers. The business marketer must ensure that the firm's channel is properly aligned to the needs of important market segments. At the same time, the marketer must also satisfy the needs of channel members, whose support is crucial to the success of business marketing strategy. After reading this chapter, you will understand:*

1. the alternative paths to business market customers.
2. the critical role of industrial distributors and manufacturers' representatives in marketing channels.
3. the central components of channel design.
4. requirements for successful channel strategy.

*Go to Market Strategy*, an influential book by Lawrence G. Friedman, aptly describes the central focus of a channel strategy in the business market:

The success of every go-to-market decision you make, indeed your ability to make smart go-to-market decisions at all, depends on how well you understand your customers. . . . You must build an accurate customer fact-base that clarifies who the customers are in your target market, what they buy, how they buy it, how they want to buy it, and what would motivate them to buy more of it from you.<sup>1</sup>

The channel component of business marketing strategy has two important and related dimensions. First, the channel structure must be designed to accomplish marketing objectives. However, selecting the best channel to accomplish objectives is challenging because (1) the alternatives are numerous, (2) marketing goals differ, and (3) business market segments are so various that separate channels must often be used concurrently. The ever-changing business environment requires managers periodically to reevaluate the channel structure. Stiff competition, new customer requirements, and the rapid growth of the Internet are among the forces that create new opportunities and signal the need for fresh channel strategies.<sup>2</sup>

Second, once the channel structure has been specified, the business marketer must manage the channel to achieve prescribed goals. To do so, the manager must develop procedures for selecting intermediaries, motivating them to achieve desired performance, resolving conflict among channel members, and evaluating performance. This chapter provides a structure for designing and administering the business marketing channel.

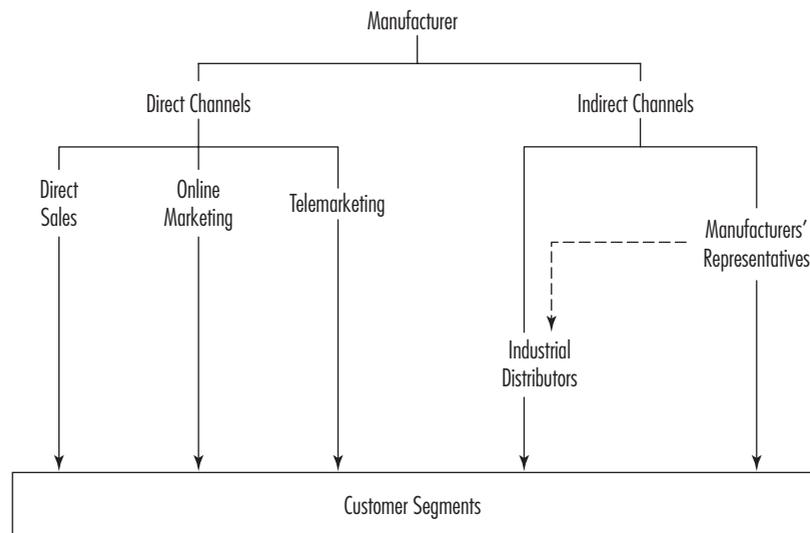
## The Business Marketing Channel

The link between manufacturers and customers is the **channel of distribution**. The channel accomplishes all the tasks necessary to effect a sale and deliver products to the customer. These tasks include making contact with potential buyers, negotiating, contracting, transferring title, communicating, arranging financing, servicing the product, and providing local inventory, transportation, and storage. These tasks may be performed entirely by the manufacturer or entirely by intermediaries, or may be shared between them. The customer may even undertake some of these functions; for example, customers granted certain discounts might agree to accept larger inventories and the associated storage costs.

Fundamentally, channel management centers on these questions: *Which channel tasks will be performed by the firm, and which tasks, if any, will be performed by channel members?* Figure 11.1 shows various ways to structure business marketing channels. Some channels are **direct**—the manufacturer must perform all the marketing functions needed to make and deliver products. The manufacturer's direct sales force and online marketing channels are examples. Others are **indirect**; that is, some type of intermediary (such as a distributor or dealer) sells or handles the products.

<sup>1</sup>Lawrence G. Friedman, *Go to Market: Advanced Techniques and Tools for Selling More Products, to More Customers, More Profitably* (Boston: Butterworth-Heinemann, 2002), p. 116.

<sup>2</sup>Bert Rosenbloom, "Multi-Channel Strategy in Business-to-Business Markets," *Industrial Marketing Management* 36 (January 2007): pp. 4–7.

FIGURE 11.1 | **B2B MARKETING CHANNELS**

A basic issue in channel management, then, is how to structure the channel so that the tasks are performed optimally. One alternative is for the manufacturer to do it all.

### *Direct Channels*

Direct distribution, common in business marketing, is a channel strategy that does not use intermediaries. The manufacturer's own sales force deals directly with the customer, and the manufacturer has full responsibility for performing all the necessary channel tasks. Direct distribution is often required in business marketing because of the nature of the selling situation or the concentrated nature of industry demand. The direct sales approach is feasible when (1) the customers are large and well defined, (2) the customers insist on direct sales, (3) sales involve extensive negotiations with upper management, and (4) selling has to be controlled to ensure that the total product package is properly implemented and to guarantee a quick response to market conditions.

A direct sales force is best used for the most complex sales opportunities: highly customized solutions, large customers, and complex products. Customized solutions and large customer accounts require professional account management, deep product knowledge, and a high degree of selling skill—all attributes a sales representative must possess. Also, when risk in a purchase decision is perceived as high and significant expertise is required in the sale, customers demand a high level of personal attention and relationship building from the direct sales force as a precondition for doing business. However, according to Lawrence Friedman and Timothy Furey, “in the broad middle market and small-customer market, where transactions are generally simpler, other channels can do a more cost-effective job—and can often reach more customers.”<sup>3</sup>

<sup>3</sup>Lawrence G. Friedman and Timothy R. Furey, *The Channel Advantage* (Boston: Butterworth-Heinemann, 1999), p. 84.

## INSIDE BUSINESS MARKETING

### IBM Uses the Internet to Collaborate with Channel Partners and Build Customer Loyalty

The Internet provides a valuable way for business marketers to collaborate with distributors or other resellers, sharing resources and cooperating on electronic marketing initiatives. An excellent example of this channel outreach program is IBM TeamPlayers (<http://www.ibm-teamplayers.com>). This program uses the Web as a communications and information delivery tool to service the channel members (business partners) of IBM.

IBM TeamPlayers offers channel members customized direct-mail campaigns using mail, fax, and e-mail to reach those customers. The Web site is also an outlet for providing help to channel partners in managing their customer databases, developing

Web pages, executing telemarketing campaigns, and more, with IBM acting as a clearinghouse for other needed resources.

The program strengthens IBM's relationship with its channel partners. Moreover, the initiative allows IBM to identify and reach end users through the partners and helps strengthen customer loyalty to both IBM channel members and to IBM itself.

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SOURCE: Barry Silverstein, *Business-to-Business Internet Marketing: Five Proven Strategies for Increasing Profits Through Internet Direct Marketing* (Gulf Breeze, Fla.: MAXIMUM Press, 1999), p. 307.

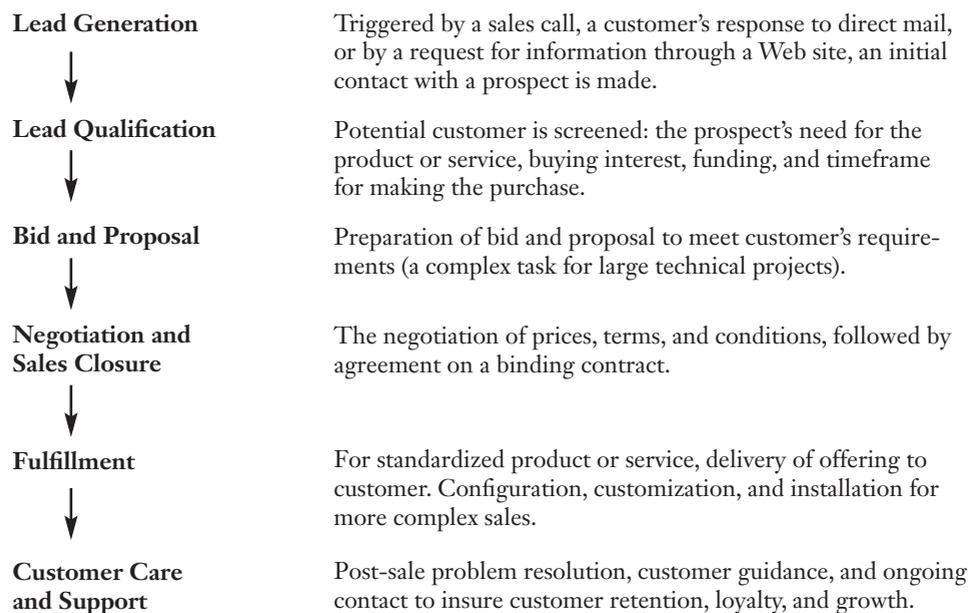
Many business marketing firms, such as Xerox, Cisco, and Dell, emphasize e-commerce strategies. Surprisingly, many firms use their Web sites only for promotional purposes and not yet as a sales channel. E-channels can be used by business marketing firms as (1) information platforms, (2) transaction platforms, and (3) platforms for managing customer relationships. The effect on the business increases as a firm moves from level one to level three. E-commerce strategies are fully explored in Chapter 12.

### *Indirect Channels*

Indirect distribution uses at least one type of intermediary, if not more. Business marketing channels typically include fewer types of intermediaries than do consumer-goods channels. Indirect distribution accounts for a large share of sales in the United States. The Gartner Group reports that 60 percent of the U.S. Gross Domestic Product (GDP) is sold through indirect channels.<sup>4</sup> Manufacturers' representatives and industrial distributors account for most of the transactions handled in this way. Indirect distribution is generally found where (1) markets are fragmented and widely dispersed, (2) low transaction amounts prevail, and (3) buyers typically purchase a number of items, often different brands, in one transaction.<sup>5</sup> For example, IBM's massive sales organization concentrates on large corporate, government, and institutional customers. Industrial distributors effectively and efficiently serve literally thousands of other IBM customers—small to medium-sized organizations. These channel partners assume a vital role in IBM's strategy on a global scale.

<sup>4</sup>The Gartner Group, "Partnerware Reports, 'Top 10 Tips for Managing Indirect Sales Channels,'" <http://www.businesswire.com>, June 18, 2002.

<sup>5</sup>E. Raymond Corey, Frank V. Cespedes, and V. Kasturi Rangan, *Going to Market: Distribution Systems for Industrial Products* (Boston: Harvard University Press, 1989), p. 26.

**FIGURE 11.2 | TYPICAL SALES CYCLE: TASKS PERFORMED THROUGHOUT THE SALES PROCESS**

SOURCE: Adapted from Lawrence G. Friedman, *Go to Market Strategy: Advanced Techniques and Tools for Selling More Products, to More Customers, More Profitably* (Boston: Butterworth-Heinemann, 2002), pp. 234–236.

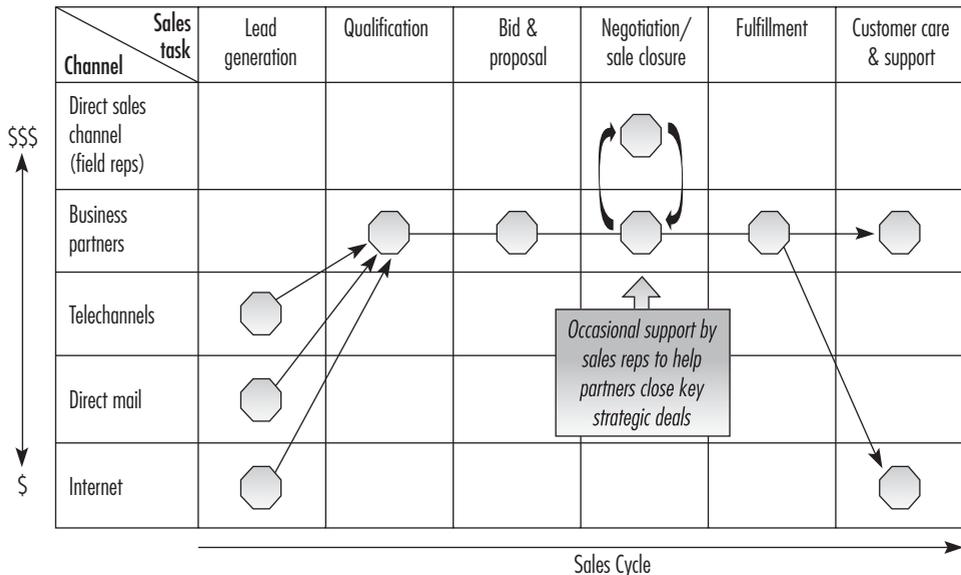
### *Integrated Multichannel Models<sup>6</sup>*

Leading business marketing firms use multiple sales channels to serve customers in a particular market. The goal of a multichannel model is to coordinate the activities of many channels, such as field sales representatives, channel partners, call centers, and the Web, to enhance the total customer experience and profitability. Consider a typical sales cycle that includes the following tasks: lead generation, lead qualification, negotiation and sales closure, fulfillment, and customer care and support (Figure 11.2). In a multichannel system, different channels can perform different tasks within a single sales transaction with a customer. For example, business marketing firms might use a call center and direct mail to generate leads, field sales representatives to close sales, business partners (for example, industrial distributors) to provide fulfillment (that is, deliver or install product), and a Web site to provide postsale support.

**Managing Customer Contact Points** Figure 11.3 shows a particular multichannel strategy that a number of leading firms like Oracle Corporation use to reach the vast middle market composed of many small and medium-sized businesses. First, the channels are arranged from top to bottom in terms of their *relative cost of sales* (that is, direct sales is the most expensive, whereas the Internet is the least). By shifting any selling tasks to lower-cost channels, the business marketer can boost profit margins and reach more customers, in more markets, more efficiently.

<sup>6</sup>This section is based on Friedman, *Go to Market*, pp. 229–257.

**FIGURE 11.3** | **MULTICHANNEL INTEGRATION MAP: SIMPLE EXAMPLE OF HIGH-COVERAGE PARTNERING MODEL**



SOURCE: Lawrence G. Friedman, *Go to Market Strategy: Advanced Techniques and Tools for Selling More Products, to More Customers, More Profitably* (Boston: Butterworth-Heinemann, 2002), p. 243. Copyright 2002. Reprinted with permission from Elsevier Science.

**Business Partner’s Key Role** Returning to Figure 11.3, observe the central role of business partners across the stages of the sales cycle. Low-cost, direct-to-customer channels—like the Internet—are used to generate sales leads, which are then given to channel partners. These partners are then expected to complete the sales cycle but can secure assistance from Oracle’s sales representatives to provide guidance and support (when needed) in closing the sale. By emphasizing the partner channel for middle-market customers, Oracle can significantly increase market coverage and penetration while enjoying higher profit margins and lower selling costs. Moreover, this allows the sales force to concentrate on large enterprise customers.

This provides just one example of how a firm can coordinate and configure sales cycle tasks across various sales channels to create an integrated strategy for a particular market. Any firm that serves a variety of markets requires distinctly different multichannel models to serve customers in those markets. To illustrate, a company might serve key corporate accounts through sales representatives and the middle market through channel partners, call centers, and the Internet.

**Customer Relationship Management (CRM) Systems** Many business marketing firms pursue very complex market coverage strategies and use *all* of the alternative paths to the market we have discussed. For example, Hewlett-Packard sells directly through a field sales organization to large enterprises; through channel partners and resellers to the government, education, and the midsize business market; and through retail stores to the small business and home market. Notes Lawrence Friedman, a leading sales strategy consultant, “Add in its customer support channels, Web presence,

and H-P has an army of channels that it deploys to provide sales, service, and support to its different market segments.”<sup>7</sup> This multichannel mix features many points of contact that H-P must manage and coordinate to ensure a “singular” customer experience across channels. CRM systems provide a valuable tool for coordinating sales channel activities and managing crucial connections and handoffs between them (see Chapter 4). Friedman notes:

Channel coordination used to be a difficult, messy problem involving the tracking and frequent loss of hand-written memos, voice mails, paper lists of sales leads, and dog-eared customer history files. CRM has ushered in a new era of IT-driven channel coordination, enabling electronic transmission of leads and customer histories from one channel to another, with no loss of information or sales information falling through the cracks.<sup>8</sup>

## Participants in the Business Marketing Channel

Channel members assume a central role in the marketing strategies of business-to-business firms, large and small. A channel management strategy begins with an understanding of the intermediaries that may be used. Primary attention is given to two: (1) industrial distributors and (2) manufacturers’ representatives. They handle a sizable share of business-to-business sales made through intermediaries.

### *Distributors*

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Industrial distributors are the most pervasive and important single force in distribution channels. Distributors in the United States number more than 10,000, with sales exceeding \$50 billion. Distributors are heavily used for MRO (maintenance, repair, and operations) supplies, with many industrial buyers reporting that they buy as much as 75 percent of their MRO supplies from distributors. Generally, about 75 percent of all business marketers sell *some* products through distributors. What accounts for the unparalleled position of the distributor in the industrial market? What role do distributors play in the industrial distribution process?

Distributors are generally small, independent businesses serving narrow geographic markets. Sales average almost \$2 million, although some top \$3 billion. Net profits are relatively low as a percentage of sales (4 percent); return on investment averages 11 percent. The typical order is small, and the distributors sell to a multitude of customers in many industries. The typical distributor is able to spread its costs over a sizable group of vendors—it stocks goods from between 200 and 300 manufacturers. A sales force of outside and inside salespersons generates orders. *Outside salespersons* make regular calls on customers and handle normal account servicing and technical assistance. *Inside salespersons* complement these efforts, processing orders and scheduling delivery; their primary duty is to take telephone orders. Most distributors operate from a single location, but some approach the “supermarket” status with as many as 130 branches.

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<sup>7</sup>Ibid., p. 254.

<sup>8</sup>Ibid., p. 253.

TABLE 11.1 | KEY DISTRIBUTION RESPONSIBILITIES

Responsibility	Activity
Contact	Reach all customers in a defined territory through an outside sales force that calls on customers or through an inside group that receives telephone orders
Product availability	Provide a local inventory and include all supporting activities: credit, just-in-time delivery, order processing, and advice
Repair	Provide easy access to local repair facilities (unavailable from a distant manufacturer)
Assembly and light manufacturing	Purchase material in bulk, then shape, form, or assemble to user requirements

Compared with their smaller rivals, large distributors seem to have significant advantages. Small distributors are typically unable to achieve the operating economies larger firms enjoy.<sup>9</sup> Large firms can automate much of their operations, enabling them to significantly reduce their sales and general administrative expenses, often to levels approaching 10 percent of sales.

**Distributor Responsibilities** Table 11.1 shows industrial distributors' primary responsibilities. The products they sell—cutting tools, abrasives, electronic components, ball bearings, handling equipment, pipe, maintenance equipment, and hundreds more—are generally those that buyers need quickly to avoid production disruptions. Thus, the critical elements of the distributor's function are to have these products readily available and to serve as the manufacturer's selling arm.

**Distributors** are full-service intermediaries; that is, they take title to the products they sell, and they perform the full range of marketing functions. Some of the more important functions are providing credit, offering wide product assortments, delivering goods, offering technical advice, and meeting emergency requirements. Not only are distributors valuable to their manufacturer-suppliers but their customers generally view them favorably. Some purchasing agents view the distributor as an extension of their "buying arms" because they provide service, technical advice, and product application suggestions.

*A Service Focus* To create more value for their customers, many large distributors have expanded their range of services. Value is delivered through various supply chain and inventory management services, including automatic replenishment, product assembly, in-plant stores, and design services.<sup>10</sup> The most popular services involve helping customers design, construct, and, in some cases, operate a supply network. Other value-adding activities include partnerships in which the distributor's field application engineers work at a customer's site to help select components for new product designs. To reap the profits associated with these important services, many distributors now charge separate fees for each unique service.

<sup>9</sup>Heidi Elliott, "Distributors, Make Way for the Little Guys," *Electronic Business Today* 22 (September 1996): p. 19.

<sup>10</sup>Jim Carbone, "Distributors See Slow Growth Ahead; Expect Electronics Distributors to Offer More Supply Chain and Inventory Services, but Be Prepared to Pay for Them," *Purchasing* 130 (May 16, 2002): p. 27.

**Classification of Distributors** To select the best distributor for a particular channel, the marketing manager must understand the diversity of distributor operations. Industrial distributors vary according to product lines and user markets. Firms may be ultraspecialized (for example, selling only to municipal water works), or they may carry a broad line of generalized industrial products. However, three primary distributor classifications are usually recognized.

1. **General-line distributors** cater to a broad array of industrial needs. They stock an extensive variety of products and could be likened to the supermarket in consumer-goods markets.
2. **Specialists** focus on one line or on a few related lines. Such a distributor may handle only power transmission equipment—belts, pulleys, and bearings. The most common specialty is fasteners, although specialization also occurs in cutting tools, power transmission equipment, pipes, valves, and fittings. There is a trend toward increased specialization as a result of increasing technical complexity of products and the need for higher levels of precision and quality control.
3. A **combination house** operates in two markets: industrial and consumer. Such a distributor might carry electric motors for industrial customers and hardware and automotive parts to be sold through retailers to final consumers.

**Choosing a Distributor** The selection of a distributor depends on the manufacturer's requirements and the needs of target customer segments. The general-line distributor offers the advantage of one-stop purchasing. If customers do not need a high level of service and technical expertise, the general-line distributor is a good choice. The specialist, on the other hand, provides the manufacturer with a high level of technical capability and a well-developed understanding of complex customer requirements. Specialists handle fasteners, for instance, because of the strict quality-control standards that users impose.

Manufacturers and their distributors are finding the Internet to be a major catalyst for stimulating collaboration. A recent poll asked distributors which business strategies would have the largest effect on them in the future, and the top two were collaboration with supply chain partners and new information technologies.<sup>11</sup> E-collaboration includes sales and services, ordering and billing, technical training and engineering, Internet meetings, auctions, and exchanges. These results suggest that Internet collaboration is a critical strategic force in the business-to-business arena.

**The Distributor as a Valuable Partner** The quality of a firm's distributors is often the difference between a highly successful marketing strategy and an ineffective one. Customers prize good distributors, making it all the more necessary to strive continually to engage the best in any given market. Distributors often provide the only economically feasible way of covering the entire market.

In summary, the industrial distributor is a full-service intermediary who takes title to the products sold; maintains inventories; provides credit, delivery, wide product assortment, and technical assistance; and may even do light assembly and manufacturing. Although the distributor is primarily responsible for contacting and supplying

<sup>11</sup> Al Tuttle, "E-Collaboration: Build Trust and Success," *Industrial Distribution* 92 (June 1, 2002): p. 59.

present customers, industrial distributors also solicit new accounts and work to expand the market. They generally handle established products—typically used in manufacturing operations, repair, and maintenance—with a broad and large demand.

Industrial distributors are a powerful force in business marketing channels, and all indications point to an expanded role for them. The manufacturer's representative is an equally viable force in the business marketing channel.

### *Manufacturers' Representatives*

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For many business marketers who need a strong selling job with a technically complex product, **manufacturers' representatives**, or reps, are the only cost-effective answer. In fact, Erin Anderson and Bob Trinkle note that the one area untouched by the outsourcing boom is field selling in the business-to-business area. They contend that many companies could benefit by using outsourced sales professionals, namely manufacturers' reps, to augment or even replace the field sales force.<sup>12</sup> Reps are salespeople who work independently (or for a rep company), represent several companies in the same geographic area, and sell noncompeting but complementary products.

**The Rep's Responsibilities** A rep neither takes title to nor holds inventory of the products handled. (Some reps do, however, keep a limited inventory of repair and maintenance parts.) The rep's forte is expert product knowledge coupled with a keen understanding of the markets and customer needs. Reps are usually limited to defined geographical areas; thus, a manufacturer seeking nationwide distribution usually works with several rep companies. Compared with a distributor channel, a rep generally gives the business marketer more control because the firm maintains title and possession of the goods.

**The Rep-Customer Relationship** Reps are the manufacturers' selling arm, making contact with customers, writing and following up on orders, and linking the manufacturer with the industrial end users. Although paid by the manufacturer, the rep is also important to customers. Often, the efforts of a rep during a customer emergency (for example, an equipment failure) mean the difference between continuing or stopping production. Most reps are thoroughly experienced in the industries they serve—they can offer technical advice while enhancing the customer's leverage with suppliers in securing parts, repair, and delivery. The rep also provides customers with a continuing flow of information on innovations and trends in equipment, as well as on the industry as a whole.

**Commission Basis** Reps are paid a commission on sales; the commission varies by industry and by the nature of the selling job. Commissions typically range from a low of 2 percent to a high of 18 percent for selected products. The average commission rate is 5.3 percent.<sup>13</sup> Percentage commission compensation is attractive to manufacturers because they have few fixed sales costs. Reps are paid only when they generate orders, and commissions can be adjusted based on industry conditions. Because reps are paid on commission, they are motivated to generate high levels of sales—another fact the manufacturer appreciates.

<sup>12</sup>Erin A. Anderson and Bob Trinkle, *Outsourcing the Sales Function: The Real Cost of Field Sales* (Mason, Ohio: Thomson Higher Education, 2005); see also, Daniel H. McQuiston, "A Conceptual Model for Building and Maintaining Relationships between Manufacturers' Reps and Their Principals," *Industrial Marketing Management* 30 (February 2001): pp. 165–181.

<sup>13</sup>*Ibid.*, p. 22.

## B2B TOP PERFORMERS

### Why Intel Uses Reps

Intel has a strong corporate brand, an experienced corporate sales force, and long-standing relationships with broad-line distributors like Arrow Electronics. Intel also uses manufacturers' representatives. Why?

After purchasing a business unit from Digital Equipment Corporation in 1998, Intel realized that several product lines from the acquired unit provided promising market potential, particularly in networking and communications. Specifically, the product lines could spur profitable growth in embedded applications market segments, such as medical equipment and point-of-sale terminals, where the proper application function is based on microprocessors and network connections. At Intel, however, marketing managers argued that the go-to-market strategy that has proved so successful in the PC market would not be suitable for original equipment manufacturers (OEMs) in these sectors.

George Langer, Intel's worldwide representative program manager, explains:

There was no sales organization, few customer relationships, and more than a few OEMs who questioned Intel's renewed interest in the embedded segments. Intel did not have existing capability to get these product lines in front of appropriate customers. The customer base was large and diverse. (This was not the PC OEM customer base where Intel had nurtured strong relationships over time.) And, finally, the value of the Intel brand was not clearly associated with communications, embedded, and networking market segments. Intel turned to outsourced selling [that is, manufacturers' reps].

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SOURCE: Erin Anderson and Bob Trinkle, *Outsourcing the Sales Function: The Real Cost of Field Sales* (Mason, Ohio: Thomson Higher Education, 2005), pp. 74–75.

**Experience** Reps possess sophisticated product knowledge and typically have extensive experience in the markets they serve. Most reps develop their field experience while working as salespersons for manufacturers. They are motivated to become reps by the desire to be independent and to reap the substantial monetary rewards possible on commission.

#### When Reps Are Used

- *Large and Small Firms:* Small and medium-sized firms generally have the greatest need for a rep, although many large firms—for example, Dow Chemical, Motorola, and Intel—use them. The reason is primarily economic: Smaller firms cannot justify the expense of maintaining their own sales forces. The rep provides an efficient way to obtain total market coverage, with costs incurred only as sales are made. The quality of the selling job is often very good as a result of the rep's prior experience and market knowledge.
- *Limited Market Potential:* The rep also plays a vital role when the manufacturer's market potential is limited. A manufacturer may use a direct sales force in heavily concentrated business markets, where the demand is sufficient to support the expense, and use reps to cover less-dense markets. Because the rep carries several lines, expenses can be allocated over a much larger sales volume.
- *Servicing Distributors:* Reps may also be employed by a firm that markets through distributors. When a manufacturer sells through hundreds of distributors across the United States, reps may sell to and service those distributors.

- *Reducing Overhead Costs:* Sometimes the commission rate paid to reps exceeds the cost of a direct sales force, yet the supplier continues to use reps. This policy is not as irrational as it appears. Assume, for example, that costs for a direct sales force approximate 8 percent of sales and that a rep's commission rate is 11 percent. Using reps in this case is often justified because of the hidden costs of a sales force. First, the manufacturer does not provide fringe benefits or a fixed salary to reps. Second, the costs of training a rep are usually limited to those required to provide product information. Thus, using reps eliminates significant overhead costs.

**Multiple Paths to Market** A wide array of factors influences the choice of intermediaries, with the tasks they perform being of prime importance.

*Different Market Segments* The primary reason for using more than one type of intermediary for the same product is that different market segments require different channel structures. Some firms use three distinct approaches. Large accounts are called on by the firm's own sales force, distributors handle small repeat orders, and manufacturers' reps develop the medium-sized firm market.

*How Customers Buy* Like size of accounts, differences in purchase behavior may also dictate using more than one type of intermediary. If a firm produces a wide line of industrial products, some may require high-caliber selling to numerous buying influences in a single buyer's firm. When this occurs, the firm's own sales force would focus on the more complex buying situations, whereas the distributors would sell standardized products from local stocks.

## Channel Design

**Channel design** is the dynamic process of developing new channels where none existed and modifying existing channels. The business marketer usually deals with modification of existing channels, although new products and customer segments may require entirely new channels. Regardless of whether the manager is dealing with a new channel or modifying an existing one, channel design is an active rather than a passive task. Effective distribution channels do not simply evolve; they are developed by management, which takes action on the basis of a well-conceived plan that reflects overall marketing goals. Business firms formulate their marketing strategies to appeal to selected market segments, to earn targeted levels of profits, to maintain or increase sales and market share growth rates, and to achieve all this within specified resource constraints. Each element of the marketing strategy has a specific purpose.

Channel design is best conceptualized as a series of stages that the business marketing manager must complete to be sure that all important channel dimensions have been evaluated (Figure 11.4). The result of the process is to specify the structure that provides the highest probability of achieving the firm's objectives.<sup>14</sup> Note that the process focuses on channel structure and not on channel participants. **Channel structure** refers to the underlying framework: the number of channel levels, the number and types of intermediaries, and the linkages among channel members. Selection of individual intermediaries is indeed important—it is examined later in the chapter.

<sup>14</sup>The discussion that follows is based on V. Kasturi Rangan, *Transforming Your Go-To-Market Strategy: The Three Disciplines of Channel Management* (Boston: Harvard Business Press, 2006), pp. 73–88.

FIGURE 11.4 | THE CHANNEL DESIGN PROCESS



SOURCE: Adapted from V. Kasturi Rangan, *Transforming Your Go-To-Market Strategy: The Three Disciplines of Channel Management* (Boston: Harvard Business Press, 2006), pp. 73–94.

### Step 1: Define Customer Segments

The primary goal of the distribution channel is to satisfy end-user needs, so the channel design process should begin there. Step 1 is about defining target market segments (see Chapter 5) and isolating the customer buying and usage behavior in each segment (what they buy, how they buy, and how they put their purchases to use).

Some business marketers err by considering their channel partners as “customers and rarely looking beyond them.” To inform the channel design process, however, the marketing strategist should center on the importance of the product from the customer’s perspective. V. Kasturi Rangan observes:

Producers of agricultural channels, for example, should target farmers and not dealers. Producers of engineering plastics (pellets) for automobile bumpers, on the other hand, should focus on the auto manufacturer and not the consumer, because *that is where the product has value in the eyes of the end user*. . . . Other features of the automobile (not bumpers) are more salient [in the choice decision at the consumer level].<sup>15</sup>

### Step 2: Customers' Channel Needs by Segment

Identifying and prioritizing the channel function requirements for customers in each market segment is next. This information should be elicited directly from a sample of present or potential customers from each segment. Table 11.2 provides a representative list of channel functions that may be more or less important to customers in a particular segment. For example, large customers for information-technology products might rank product customization, product quality assurance, and after-sales service as their top three needs. Whereas small customers may prioritize product information, assortment, and availability as their most important needs. The business marketing manager should also probe customers on other issues that might provide strategy

<sup>15</sup>Ibid., p. 76.

TABLE 11.2 | CHANNEL FUNCTIONS ALIGNED WITH CUSTOMER NEEDS

Channel Function	Customer Needs
1. Product Information	Customers seek more information for new and/or technically complex products and those that are characterized by a rapidly changing market environment.
2. Product Customization	Some products must be technically modified or need to be adapted to meet the customer's unique requirements.
3. Product Quality Assurance	Because of its importance to the customer's operations, product integrity and reliability might be given special emphasis by customers.
4. Lot Size	For products that have a high unit value or those that are used extensively, the purchase represents a sizable dollar outlay and a significant financial decision for the customer.
5. Assortment	A customer may require a broad range of products, including complementary items, and assign special value to one-stop shopping.
6. Availability	Some customer environments require the channel to manage demand uncertainty and support a high level of product availability.
7. After-Sales Services	Customers require a range of services from installation and repair to maintenance and warranty.
8. Logistics	A customer organization may require special transportation and storage services to support its operations and strategy.

SOURCE: Adapted from V. Kasturi Rangan, Melvyn A. J. Menezes, and E. B. Maier, "Channel Selection for New Industrial Products: A Framework, Method, and Application," *Journal of Marketing* 56 (July 1992): pp. 72–74.

insights. For instance, how sensitive are customers to a two-hour versus six-hour service response time, or how much value do they perceive in a three-year versus one-year warranty?

### **Step 3: Assess the Firm's Channel Capabilities**

Once customer requirements have been isolated and prioritized, an assessment is made of the strengths and weaknesses of the firm's channel. The central focus is on identifying the gaps between what customers in a segment desire and what the channel is now providing. Customers base their choice of a channel not on a single element, but on a complete bundle of benefits (that is, channel functions). To that end, the business-to-business firm should identify particular channel functions, like after-sales support or availability, where action could be taken to enhance the customer value proposition.

### **Step 4: Benchmark to Competitors**

What go-to-market strategies are key competitors using? In designing a channel, cost considerations prevent the business marketer from closing all the gaps on channel capabilities that may appear. However, a clear direction for strategy is revealed by understanding the channel offerings of competitors. For example, an aggressive

competitor that goes to market with its own team of account managers and dedicated service specialists might demonstrate special strength in serving large corporate customers. However, countless opportunities exist for smaller rivals to counter this strategy by developing special channel offerings tailored to small and medium-sized customers (for example, Intuit's success in retaining its market leadership position in small-business accounting software despite the aggressive challenge from Microsoft).

### ***Step 5: Create Channel Solutions for Customers' Latent Needs***

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Sometimes, a review of competitor offerings can alert the marketer to opportunities for new offerings that may have special appeal to customers. "At other times, customers' needs may be latent and unarticulated, and it is the channel steward's responsibility to tap into and surface those requirements."<sup>16</sup> Based on such an assessment, a provider of information-technology equipment created an entirely new channel option for the small and medium-sized customer segment. Rather than selling equipment, this new channel takes responsibility for installing, upgrading, and maintaining the equipment at the customers' locations for an ongoing service fee.

### ***Step 6: Evaluate and Select Channel Options***

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Channel decisions must ultimately consider the cost-benefit trade-offs and the estimated profitability that each of the viable channel options present.<sup>17</sup> Some of the channel gaps that are uncovered in this assessment can be closed by the independent actions and investments of the business-to-business firm (for example, adding to the service support staff or the sales force). For the most part, however, the greatest progress will come from the channel partners (for example, distributors or reps) working together and discussing how channel capabilities can be aligned to customer needs. "The idea is to enhance the value delivered to customers through collaborative action among channel partners. If the partners can agree on how to pull it off and, indeed, accomplish their redefined tasks,"<sup>18</sup> they will squarely respond to customer needs and advance the performance of the channel. One important implication of the framework is that the design of the channel must change as customer and competitor behavior changes. Rather than a static structure, channel management is an ongoing process involving continuous adjustments and evolution.

### ***Crucial Points in Channel Transformation***

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Marketing channels are often thought of as a series of product and information flows that originate with the business-to-business firm. In his rich and compelling perspective of the channel design process, V. Kasturi Rangan turns this notion on its head (see Figure 11.5):

The starting point is the customer, and the customer's demand-chain requirements. The channel is constructed to meet this core need. Roles, responsibilities, and rewards are allocated as a consequence of this need, and not the other way around.<sup>19</sup>

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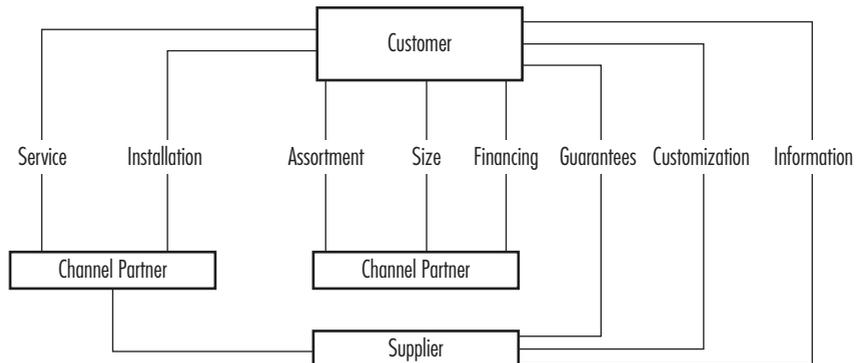
<sup>16</sup>Ibid., p. 83.

<sup>17</sup>Arun Sharma and Anuj Mehrotra, "Choosing an Optimal Mix in Multichannel Environments," *Industrial Marketing Management* 36 (January 2007): pp. 21–28.

<sup>18</sup>Rangan, *Transforming Your Go-to-Market Strategy*, p. 88.

<sup>19</sup>Ibid., p. 91.

FIGURE 11.5 | CUSTOMERS DRIVE THE CHANNEL DESIGN PROCESS



SOURCE: V. Kasturi Rangan, *Transforming Your Go-To-Market Strategy: The Three Disciplines of Channel Management* (Boston: Harvard Business Press, 2006), p. 91.

## Channel Administration

Once a particular business-to-business channel structure is chosen, channel participants must be selected, and arrangements must be made to ensure that all obligations are assigned. Next, channel members must be motivated to perform the tasks necessary to achieve channel objectives. Third, conflict within the channel must be properly controlled. Finally, performance must be controlled and evaluated.

### Selection of Channel Members

Why is the selection of channel members (specific companies, rather than *type*, which is specified in the design process) part of channel management rather than an aspect of channel design? The primary reason is that intermediary selection is an ongoing process—some intermediaries choose to leave the channel, and the supplier terminates others. Thus, selection of intermediaries is more or less continuous. Performance of individual channel members must be evaluated continually. The manufacturer should be prepared to move quickly, replacing poor performers with potentially better ones. Including the selection process in ongoing channel management puts the process in its proper perspective.

**Securing Good Intermediaries** The marketer can identify prospective channel members through discussions with company salespeople and existing or potential customers, or through trade sources, such as *Industrial Distribution* magazine or the *Verified Directory of Manufacturers' Representatives*. Once the list of potential intermediaries is reduced to a few names, the manufacturer uses the selection criteria to evaluate them. For example, the McGraw-Edison Company uses an intensive checklist to compare prospective channel members; important criteria are market coverage, product lines, personnel, growth, and financial standing.

The formation of the channel is not at all a one-way street. The manufacturer must now persuade the intermediaries to become part of the channel system. Some distributors

evaluate potential suppliers just as rigorously as the manufacturers rate them—using many of the same considerations. Manufacturers must often demonstrate the sales and profit potential of their product and be willing to grant the intermediaries some territorial exclusivity. Special efforts are required to convince the very best rep in a market to represent a particular manufacturer's product. Those efforts must demonstrate that the manufacturer will treat the rep organization as a partner and support it.

### ***Motivating Channel Members***

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Distributors and reps are independent and profit oriented. They are oriented toward their customers and toward whatever means are necessary to satisfy customer needs for industrial products and services. Their perceptions and outlook may differ substantially from those of the manufacturers they represent. As a consequence, marketing strategies can fail when managers do not tailor their programs to the capabilities and orientations of their intermediaries. To manage the business marketing channel effectively, the marketer must understand the intermediaries' perspective and devise ways to motivate them to perform in a way that enhances the manufacturer's long-term success. The manufacturer must continually seek support from intermediaries, and the quality of that support depends on the motivational techniques used.

**A Partnership** Channel member motivation begins with the understanding that the channel relationship is a *partnership*. Manufacturers and intermediaries are in business together; whatever expertise and assistance the manufacturer can provide to the intermediaries improves total channel effectiveness. One study of channel relationships suggested that manufacturers may be able to increase the level of resources directed to their products by developing a trusting relationship with their reps; by improving communication through recognition programs, product training, and consultation with the reps; and by informing the reps of plans, explicitly detailing objectives, and providing positive feedback.<sup>20</sup>

Another study of distributor-manufacturer working partnerships recommended similar approaches. It also suggested that manufacturers and their distributors engage in joint annual planning that focuses on specifying the cooperative efforts each firm requires of its partner to reach its objectives and that periodically reviews progress toward objectives.<sup>21</sup> The net result is trust and satisfaction with the partnership as the relationship leads to meeting performance goals.

**Dealer Advisory Councils** One way to enhance the performance of all channel members is to facilitate the sharing of information among them. Distributors or reps may be brought together periodically with the manufacturer's management to review distribution policies, provide advice on marketing strategy, and supply industry intelligence.<sup>22</sup> Intermediaries can voice their opinions on policy matters and are brought directly into the decision-making process. Dayco Corporation uses a dealer council to

<sup>20</sup>Erin Anderson, Leonard M. Lodish, and Barton A. Weitz, "Resource Allocation in Conventional Channels," *Journal of Marketing Research* 24 (February 1987): p. 95; see also McQuiston, "A Conceptual Model for Building and Maintaining Relationships between Manufacturers' Reps and Their Principals," pp. 165–181.

<sup>21</sup>James C. Anderson and James A. Narus, "A Model of Distribution Firm and Manufacturing Firm Working Partnerships," *Journal of Marketing* 54 (January 1990): p. 56.

<sup>22</sup>Doug Harper, "Councils Launch Sales Ammo," *Industrial Distribution* 80 (September 1990): pp. 27–30.

keep abreast of distributors' changing needs.<sup>23</sup> One month after their meeting, council members receive a written report of suggestions they made and of the programs to be implemented as a result. Generally, Dayco enacts 75 percent of distributor proposals. For dealer councils to be effective, the input of channel members must have a meaningful effect on channel policy decisions.

**Margins and Commission** In the final analysis, the primary motivating device is compensation. The surest way to lose intermediary support is compensation policies that do not meet industry and competitive standards. Reps or distributors who feel cheated on commissions or margins shift their attention to products generating a higher profit. The manufacturer must pay the prevailing compensation rates in the industry and must adjust the rates as conditions change.

Intermediaries' compensation should reflect the marketing tasks they perform. If the manufacturer seeks special attention for a new industrial product, most reps require higher commissions. As noted earlier in the chapter, many industrial distributors charge separate fees for the value-added services they provide. For this approach to work effectively, it is critical that the client understands the value it is receiving for the extra charges.

**Building Trust** The very nature of a distribution channel—with each member dependent on another for success—can invite conflict. Conflict can be controlled in various ways, including channelwide committees, joint goal setting, and cooperative programs involving a number of marketing strategy elements. To compete, business marketers need to be effective at cooperating within a network of organizations—the channel. For example, an IBM executive who led the team that developed the first IBM PC in 1981 also drove the decision to sell it through dealers and later through the channel. Soon after the introduction of the PC, an executive with American Express Travel Related Services approached the IBM executive with an idea to sell the PCs directly to American Express card members. The IBM executive refused—he wanted the *channel* to get the sale. As a result, IBM secured the commitment and trust of its channel partners, setting the stage for many other strategy initiatives.<sup>24</sup>

Successful cooperation results from relationships in which the parties have a strong sense of communication and trust. Robert M. Morgan and Shelby D. Hunt suggest that relationship commitment and trust develop when (1) firms offer benefits and resources that are superior to what other partners could offer; (2) firms align themselves with other firms that have similar corporate values; (3) firms share valuable information on expectations, markets, and performance; and (4) firms avoid taking advantage of their partners.<sup>25</sup> By following these prescriptions, business marketers and their channel networks can enjoy sustainable competitive advantages over their rivals and their networks.

<sup>23</sup>James A. Narus and James C. Anderson, "Turn Your Distributors into Partners," *Harvard Business Review* 64 (March–April 1986): p. 68.

<sup>24</sup>Jeff O'Heir, "The Advocates: They Raised Their Voices to Legitimize the Channel," *Computer Reseller News*, June 17, 2002, p. 51.

<sup>25</sup>Robert M. Morgan and Shelby D. Hunt, "The Commitment-Trust Theory of Relationship Marketing," *Journal of Marketing* 58 (July 1994): pp. 20–38.

## Summary

Channel strategy is an exciting and challenging aspect of business marketing. The challenge derives from the number of alternatives available to the manufacturer in distributing business products. The excitement results from the ever-changing nature of markets, user needs, and competitors.

Channel strategy involves two primary management tasks: designing the overall structure and managing the operation of the channel. Channel design includes evaluating distribution goals, activities, and potential intermediaries. Channel structure includes the number, types, and levels of intermediaries to be used. A central challenge is determining how to create a strategy that effectively blends e-commerce with traditional channels. Business marketing firms use multiple sales channels to serve customers in a particular market segment: company salespersons, channel partners, call centers, direct mail, and the Internet. The goal of a multichannel strategy is to coordinate activities across those channels to enhance the customer's experience while advancing the firm's performance.

The primary participants in business marketing channels are distributors and reps. Distributors provide the full range of marketing services for their suppliers, although customer contact and product availability are their most essential functions. Manufacturers' representatives specialize in selling, providing their suppliers with quality representation and with extensive product and market knowledge. The rep is not involved with physical distribution, leaving that burden to the manufacturers.

The central objective of channel management is to enhance the value delivered to customers through the carefully orchestrated activities of channel partners. The channel design process hinges on deep knowledge of customer needs, and the channel structure must be adjusted as customer or competitor behavior changes. Selection and motivation of channel partners are two management tasks vital to channel success. The business marketing manager may need to apply interorganizational management techniques to resolve channel conflict. Conflict can be controlled through a variety of means, including channelwide committees, joint goal setting, and cooperative programs that demonstrate trust and commitment.

## Discussion Questions

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1. Describe the specific tasks in the typical sales cycle and discuss how different channels (for example, business partners versus the Internet) can perform different tasks within a single sales transaction.
2. Using a multichannel integration map (see Figure 11.3), illustrate how a firm might cover small and medium-sized businesses versus large corporate customers.
3. Explain how a direct distribution channel may be the lowest-cost alternative for one business marketer and the highest-cost alternative for another in the same industry.
4. Describe specific product, market, and competitive conditions that lend themselves to (a) a direct channel of distribution and (b) an indirect channel of distribution.

5. Compare and contrast the functions performed by industrial distributors and manufacturers' representatives.
6. What product/market factors lend themselves to the use of manufacturers' representatives?
7. Describe why it might be necessary for a business-to-business firm to serve some customers through reps, some through distributors, others exclusively online, and still others through a direct sales force.
8. Explain how a change in segmentation policy (that is, entering new markets) may trigger the need for drastic changes in the industrial channel of distribution.
9. Both business marketers and distributors are interested in achieving profit goals. Why, then, are manufacturer-distributor relationships characterized by conflict? What steps can the marketer take to reduce conflict and thus improve channel performance?
10. For many years, critics have charged that intermediaries contribute strongly to the rising prices of goods in the American economy. Would business marketers improve the level of efficiency and effectiveness in the channel by reducing as far as possible the number of intermediate links in the channel? Support your position.

### **Internet Exercise**

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1. Sysco Corporation is a large distributor of food and food-related products to the food-service industry. The company provides its products and services to approximately 415,000 customers, including restaurants, health-care and educational facilities, lodging establishments, and other food-service customers. Although *Cisco* is most visible in the business press, Sysco generates over \$23 billion in sales annually and has more than 45,000 employees. Go to <http://www.sysco.com> and identify some of the services Sysco provides.

## SunPower's Go-to-Market Strategy<sup>26</sup>

SunPower Corporation, a Silicon Valley–based manufacturer of solar cells and solar panels, is emerging as a potential leader in the rapidly growing, but still immature, solar industry. The firm is the leader in cell conversion efficiency, which means that its solar cells generate more electricity at a given size than its rivals. So, when space constraints and aesthetics are important considerations, this attribute makes SunPower an ideal choice for business as well as home installations. To boost energy savings, the company has also developed its own tracking systems that allow its solar panels to follow the sun throughout the day. While costing only 5 percent more to install, this proprietary feature allows for 30 percent more energy generation than traditional solar systems.

SunPower serves all sectors of the business market and its customer list includes Johnson & Johnson, FedEx, Toyota, the U.S. Postal Service, and Microsoft. The company has signed agreements with Macy's, Target, and Wal-Mart to install solar systems at all of their California locations, and this may develop into a much larger opportunity, spreading to those customers' operations across the country.

In serving large corporate customers, like Macy's, SunPower uses a direct channel that controls the complete value chain from the manufacturing of the solar panels to the installation of the system. However, the firm also sees a huge opportunity in selling its solar systems to small and medium-sized businesses (SMBs). For smaller commercial installations (less than 500 kW of peak power), SunPower is developing an indirect channel—a network of commercial dealers that will serve those SMB customers. For customers in this market segment, SunPower emphasizes these benefits:

- lowering the monthly electric bills for your business;
- installing fewer panels that provide more power, thereby reducing your costs;
- taking advantage of government incentives for solar installations;
- supporting the environment and your community.

### Discussion Questions

1. Channel design begins with an assessment of customer needs. What benefits or special services should a SunPower commercial dealer provide in order to meet the unique requirements of an SMB customer?

<sup>26</sup>Stephen Simko, "Analyst Research: SunPower Corporation," July 22, 2008, Morningstar, Inc., accessed at <http://www.morningstar.com> on July 26, 2008.

2. Describe the process that SunPower might follow to (a) evaluate potential dealers and (b) select those that will represent them in a particular city or geographical area.
3. To effectively implement channel strategy, what programs or strategies might SunPower take to better prepare and equip commercial dealers to serve SMB customers?