

Channels of distribution and logistics

LEARNING OBJECTIVES

By the end of this chapter you will:

- comprehend key elements and decisions in distribution channel design
- be able to evaluate different configurations of channel structure
- be familiar with recent trends and developments in channels of distribution
- appreciate the importance of managing the physical flows of products, services and information into, through, and out of the organization to its customers
- grasp the meaning and scope of physical distribution and logistics management
- be aware of developments and trends in production and manufacturing, particularly the growth of 'lean manufacturing' and implications for logistics
- recognize the role of Information Technology and marketing in logistics

INTRODUCTION

This chapter deals with the 'place' element of marketing strategy (i.e. 'placement' of goods and services from their respective providers into the hands of customers). Before we discuss the structure of marketing channels, followed by logistics, it is useful that we look at their emergence and the functions that channels perform.

THE CONSUMER WANTS CYCLE

The word 'channel' has its origins in the word for canal, which for marketing can be interpreted as a route taken by products as they flow from production to points of intermediate and final use. Marketing is a key factor in a continuous cycle that begins and ends with consumer wants. It is the role of the marketer to interpret consumer wants and combine them with empirical market data such as location of consumers, their numbers and preferences, to establish the starting point for manufacture. On completion of manufacture, the finished product is moved to the consumer and the cycle is complete when he or she obtains satisfaction resulting from product ownership.

THE PRODUCER-USER GAP

Despite the growth of direct marketing (to be discussed in Chapter 10) in today's complex economy, most producers still do not sell directly to final users. Between them and consumers lie marketing intermediaries. A distribution channel bridges the gap between user and producer, and so plays an integral role in the operation of the marketing concept.

Relationships among channel members are influenced by the structure of the channel. Marketing channels can be described as sets of interdependent organizations involved in the process of making a product or service available for use or consumption.

DEMAND STIMULUS

In addition to marketing channels satisfying demand by supplying goods and services in the right location, at the correct quantity and price, they should stimulate demand through promotional activities of retailers, manufacturers and wholesalers. In this way, a marketing channel should be

viewed not just as a demand satisfier, but as an orchestrated network that creates value for consumers through the generation of form, possession, time and place utilities.

We start by examining ways in which distribution systems are designed and how channel policy is determined, depending on the degree of market exposure sought by a company.

DISTRIBUTION SYSTEM DESIGN

The starting point for marketing channel design is the end consumer. Although an understanding of consumer purchasing patterns is essential, there are other factors that influence channel organization:

- There may be a restriction in choice of outlets available to suppliers, e.g. retail outlets may already have been secured by established manufacturers.
- Channel design will be influenced by the number, size and geographic concentration of consumers. If customers are few in number, but large and geographically concentrated, it may be that direct channels will be suitable. If customers are dispersed, the mechanics of direct channels become increasingly difficult and there will be a need for a large number of intermediaries.
- Product characteristics affect channel design. Industrial goods manufacturers tend to use direct channels, but there are other factors that influence the decision. Perishable goods, for example, need to be turned over quickly so direct methods are often applied. Non-perishable, non-bulky goods can be handled via indirect channels.
- Some products are more suited to indirect channels because of environmental characteristics. For example, in some countries shopping is seen very much as being a leisure activity especially for items like clothing and furniture, so much so that companies such as the Swedish company IKEA have made this a central part of their business model.
- Some organizations have limited discretion over marketing channel choice owing to economic conditions and legal restrictions. In certain of the Eastern European and Baltic countries such as Estonia, Latvia and Uzbekistan there is still restricted choice in terms of the range and scope of retail outlets for marketers.

Any channel decision will have long-term implications for the company, e.g. price will be affected depending on the number of levels between the manufacturer and the end user. A decision to change channels is likely to be long term so it is important that existing channel structures are constantly reviewed to exploit opportunities.

STRATEGIC CHANNEL CHOICES

An important consideration when formulating channel policy is the degree of market exposure sought by the company. Choices available include:

- **Intensive distribution** where products are placed in as many outlets as possible. This is most common when customers purchase goods frequently, e.g. household goods such as detergents or toothpaste. Wide exposure gives customers many opportunities to buy and the image of the outlet is not important. The aim is to achieve maximum coverage.
- **Selective distribution** where products are placed in a more limited number of outlets in defined geographic areas. Instead of widespread exposure, selective distribution seeks to show products in the most promising or profitable outlets, e.g. high-end 'designer' clothes.
- **Exclusive distribution** where products are placed in one outlet in a specific area. This brings about a stronger partnership between seller and re-seller and results in strong bonds of loyalty. Part of the agreement usually requires the dealer not to carry competing lines, and the result is a more aggressive selling effort by the distributor of the company's products, e.g. an exclusive franchise to sell a vehicle brand in a specific geographical area, in return for which the franchisee agrees to supply an appropriate after sales service back-up.

We can see that there are several key decisions to make when determining the company's distribution system. Its importance is underlined by the fact that the choice of distribution channel has an effect on all elements of the marketing mix and these are long term.

TYPES AND CLASSIFICATION OF CHANNELS

Marketing channels can be characterized according to the number of channel levels. Each institution that works to bring the product to the point of consumption is included. The number of intermediaries involved in channel operation determines on how many levels it operates. There are four main types of channel level in consumer markets as shown in Figure 6.1. The first three levels (zero, one and two) are self explanatory. The three level channel includes a 'jobber', or merchant

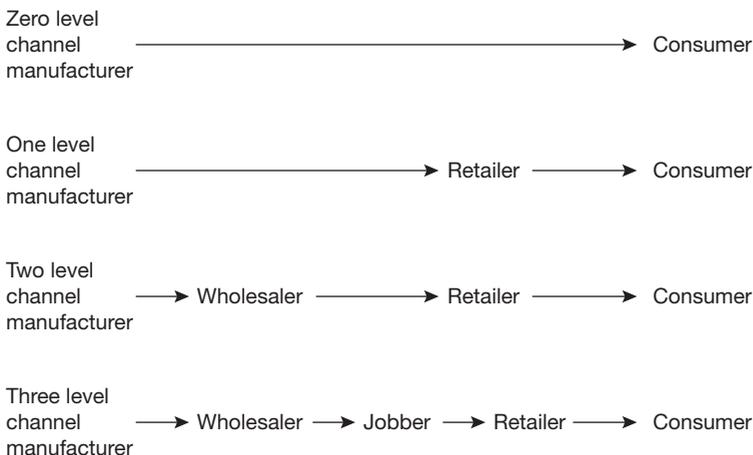


FIGURE 6.1 Channel relationships

wholesaler who intervenes between the wholesaler and retailer. It is the jobber's role to buy from wholesalers and sell to smaller retailers, who are not usually serviced by larger wholesalers.

Within each channel, intermediaries are connected by three types of flow:

- 1 **Physical flow** describes movement of goods from raw material that is processed in various stages of manufacture until it reaches the final consumer. In the case of a towel manufacturer raw material is cotton yarn which flows from the grower via transporters to the manufacturer's warehouses and plants.
- 2 **Title flow** is the passage of ownership from one channel institution to another; when manufacturing towels, title to raw materials passes from the supplier to the manufacturer. Ownership of finished towels passes from manufacturer to the wholesaler or retailer and then to the final consumer.
- 3 **Information flow** involves the directed flow of influence from activities such as advertising, personal selling, sales promotion and publicity from one member to other members in the system. Manufacturers of towels direct promotion, and information flows to retailers or wholesalers, known as trade promotion. This type of activity may also be directed to end consumers, i.e. 'end user' promotion.

Conventional marketing channels comprise autonomous business units, each performing a defined set of marketing functions. Co-ordination among channel members is through the bargaining process. Membership of the channel is relatively easy, loyalty is low and this type of network tends to be unstable. Members rarely co-operate with each member working independently of others. Decision makers are more concerned with cost and investment relationships at a single stage of the marketing process and tend to be committed to established working practices. Most food grocery products in the European Union are marketed through conventional marketing channels; independent food and grocery producers are responsible for growing, rearing and manufacturing products and brands. These are sold through a series of wholesalers and retailers such as Sainsbury's, Aldi, Lidl, Tesco or Carrefour each operating as independent businesses in the chain and selling to their own customers.

Vertical marketing systems are in contrast to conventional channels where members co-ordinate activities between different levels of the channel to reach a desired target market. The essential feature is that participants acknowledge and desire interdependence, and view it as being in their best long-term interests. For the channel to function as a vertical marketing system, one of the member firms must be acknowledged as the leader; typically the dominant firm, which can be expected to take a significant risk position and usually has the greatest relative power within the channel. An example of a vertical marketing system is that of franchising. The franchiser, usually on the basis of having a powerful brand or perhaps a patent/copyright, for a fee, allows franchisees to produce or distribute the product or service. The franchiser effectively controls the channel, including aspects such as product ingredients, advertising and marketing, pricing, etc. through formal and legally enforceable agreements. Franchising is an example of what are termed contractual vertical marketing systems which we consider again shortly.

Corporate vertical marketing is when a company owns two or more traditional levels of the channel. In many economies corporate vertical channels have arisen as a result of a desire for growth on the part of companies through vertical integration. Two types of vertical integration are possible with respect

to the direction within which the vertical integration moves a company in the supply chain: when a manufacturer buys, say, a retail chain, this is referred to as forward integration with respect to the chain. Backward integration is moving upstream in the supply chain, e.g. when a retailer invests in manufacturing or a manufacturer invests in a raw material source. Although the end result of such movements is a corporate vertical marketing channel, often the stimulus to such movement is less to do with channel economies and efficiencies, and more with control over access to supply or demand, entry into a profitable business or overall scale and operating economies. Much vertical integration activity which took place during the 1990s in many economies resulted in lower overall profitability levels, and in some cases, the demise of companies involved, as companies overextended themselves and/or moved into areas where they had little expertise. Because of this, many companies have now turned their attention towards contractual systems for achieving growth and more control through the vertical marketing system. Many of the large oil companies are examples of corporate vertical marketing. They prospect for oil, extract it, process it, distribute and retail it through their petrol stations. Other companies operate partial corporate vertical marketing systems in that they integrate only one way. Zara (the clothing retailer) is integrated vertically backward with manufacturing facilities. Firestone (the tyre manufacturer) on the other hand, is vertically integrated forward owning its own tyre retailers.

Many companies formalize their obligations within channel networks by employing legitimate power as a means of control achieved by using contractual agreements. Nearly all transactions between businesses are covered by some form of contract, and as such the contractual agreement determines the marketing roles of each party within the contract. Indeed, the locus of authority usually lies with individual members. The most common form of contractual agreement are *franchises* and *voluntary* and *co-operative groups*.

Franchises are where the parent company grants an individual person or relatively small company the right or privilege to do business in a prescribed manner over a certain time period in a specified place. The parent company is referred to as the franchiser (or franchisor) and may occupy any position in the channel network. The franchise retailer is termed the franchisee. There are four basic types of franchise system:

- Manufacturer/retailer franchise, e.g. service stations where most of the garage petrol stations such as Shell and Esso are franchisees of the large oil exploration and refining companies.
- Manufacturer/wholesaler franchise: e.g. Coca-Cola sell drinks they manufacture to franchised wholesalers, who in turn bottle and distribute soft drinks to retailers. This type of arrangement is common in the food and drinks markets with many of the large companies franchising part of their manufacturing and or wholesaling activities to others.
- The wholesaler/retailer franchise. Many retail chains are franchisees of large wholesalers. These wholesalers saw the value of securing a measure of control, and of course a share of the retail profits, from marketing their products and brands. The most notable example is 'Spar' which advertises itself as 'Spar, your 8.00 till late shop', and of course all retail members must abide by this promise.
- The service/sponsor retailer franchise e.g. McDonald's, Kentucky Fried Chicken, Subway, Car Rental companies like Avis and Hertz and services like DynoRod and Prontaprint. This is the best known and certainly most ubiquitous of franchising arrangements and it has enabled many organizations to rapidly expand their global operations.

There are different types of franchise arrangement, e.g. McDonald's insists that franchisees purchase from official suppliers; they provide building and design specifications, help locate finance for franchisees and impose quality standards to which each unit must adhere in order to hold its franchise. Rigorous inspection through 'secret shoppers' (explained in Chapter 12) ensures franchise 'rules' are being obeyed.

Franchises share a set of common features and operating procedures:

- 1 A franchise essentially sells a nationally, or internationally, recognized trade name, process, or business format to the franchisee.
- 2 The franchiser normally offers expert advice e.g. location selection, capitalization, operation and marketing.
- 3 Most franchises operate a central purchasing system at national or international level to enable cost savings to be made at the individual franchise level.
- 4 The franchise is subject to a contract binding both parties that normally requires the franchisee to pay a franchise fee and royalty fees to the franchiser, but the franchisee owns the business as opposed to being employed.
- 5 The franchiser often provides initial and continuous training to the franchisee.

Contractual vertical marketing systems like franchising have been one of the fastest growing areas of marketing and distribution. Substantial advantages derive from the franchising system. From a system that essentially involves two independent parties voluntarily agreeing to contract with each other, advantages accrue to both the franchisee and franchiser. Advantages to the franchisee are:

- The franchisee gains the benefit of being able to sell a well-known product or service which has been market tested and known to work.
- The franchisee enjoys access to the knowledge, experience, reputation and image of the franchiser. Because of this the franchisee is able to enter a business much more easily than setting up from scratch. The learning curve is shortened, expensive mistakes can be avoided, and there is less chance of business failure.
- Although the franchisee has the backing of what is often the large organization of the franchiser, the franchisee is still essentially an independent business with all that this implies for motivation to succeed.
- The franchisee is often helped by national or international advertising and promotion by the franchiser which would be beyond the means of a small independent business.
- The franchisee enjoys the use of the franchiser's trademark, continuous research and development and market information.
- The franchiser will normally provide a system of management controls such as accountancy, sales and stock control procedures.

Advantages to the franchiser are:

- Finding and recruiting a network of franchisees enables rapid growth as wider distribution can be achieved with less capital.

- The individual franchisee is more motivated than a hired manager might be.
- The franchiser secures captive outlets for products or services, especially in the case of trade name franchising and private labels.
- Franchise and royalty fees provide a regular stream of income for the franchiser.
- The terms of the franchise contract normally give the franchiser substantial control over how the franchise is operated and normally the franchiser can terminate a contract should the relationship turn out to be unsatisfactory. The costs of such terminations are likely to be less than if the franchiser was operating a corporate owned facility with staff on the payroll. Normally, terms and restrictions on location and sale of the business by the franchisee ensure that the franchiser is able to maintain territorial exclusivity for its franchisees.

There are disadvantages, but the franchise relationship combines the strengths of both small and large scale businesses. The franchisee is the small business person who is able to respond to local market conditions and offer personal services to customers. The franchiser passes on economies of scale in national advertising and bulk purchasing. For a franchise to be successful both parties need to work towards a common goal and avoid conflicts which requires frequent and open communication between partners if the system is to meet changing market conditions while maintaining its integrity.

What constitutes the main disadvantages of franchising depends from whose perspective we are looking; the franchisee or the franchiser. The main disadvantages of franchising from each perspective are:

Disadvantages to franchiser:

- The franchiser loses some control over the provision and marketing of the brand. Poor service on the part of the franchisee can result in problems for brand image.
- Ideas and techniques can be copied even if seemingly well protected by patents and copyright arrangements.
- Some proportion of profit has to be foregone.
- There may be less commitment and enthusiasm from the franchisee.
- Often franchisees lack business skills or experience.

Disadvantages to the franchisee:

- lack of support from franchiser;
- franchiser may go out of business;
- lack of flexibility/scope to use initiative;
- close control from franchiser.

Franchising is not solely confined to consumer products like fast food. It is used for a wide range of products and services in both consumer and industrial markets.

Voluntary and co-operative groups emerged in the 1930s as a response to competition from chain stores. The scope of co-operative effort has expanded from concentrated buying power to the development of programmes involving centralized consumer advertising and promotion, store location and layout, financing, accounting and a package of support services.

Generally, wholesale sponsored voluntary groups have been more effective competitors than retail sponsored co-operative groups. Primarily this is because of the difference in channel organization between the two. In the former, a wholesaler can provide strong leadership, because it represents the locus of power within the voluntary system and this is normally supported by a brand name like 'Spar'. In the latter, power is diffused throughout the retail membership and role specification and allocation of resources are more difficult to accomplish. The principal purpose here is in bulk purchasing. In voluntary groups, retail members have relinquished some of their autonomy by making themselves highly dependent on specific wholesalers for expertise. In retail co-operative chains, individuals retain more autonomy and this tends to depend much less strongly on the supply unit for assistance and direction.

This type of organization is not to be confused with the Co-operative movement that was founded in 1844 by the Rochdale, Lancashire, Society of Equitable Pioneers who were a group of 28 weavers and other workers. As mechanization of the Industrial Revolution pushed more and more skilled workers into poverty, tradesmen banded together to open their own store selling items they could not otherwise afford. Over four months they pooled together £28 of capital. They opened their store with a basic selection of dry goods and foodstuffs and quickly moved into higher quality unadulterated produce. They devised the internationally famous *Rochdale Principles*:

- 1 open membership;
- 2 democratic control (one person, one vote);
- 3 distribution of *surplus* in proportion to *trade*;
- 4 payment of limited interest on *capital*;
- 5 political and religious neutrality;
- 6 cash trading (no credit);
- 7 promotion of education.

Administered vertical marketing systems (VMS) do not have the formal arrangements of a contractual system or the clarity of power dependence of a corporate system. It is a co-ordinated system of distribution channel organization in which the flow of products from the producer to the end user is controlled by the power and size of one member of the channel system rather than by common ownership or contractual ties. Member organizations acknowledge the existence of dependence and adhere to the leadership of the dominant firm, which may operate at any level in the channel. Large retail organizations like Marks & Spencer typify this system.

In administered systems like Marks & Spencer, units can exist with disparate goals, but there is informal collaboration on inclusive goals. Decision making occurs by virtue of interaction between channel members in the absence of a formal inclusive structure. However, the locus of authority still remains with individual channel members. As in conventional channels commitment is self-oriented and there is a minimum amount of system-wide orientation among the members. As McCammon¹ observes:

Manufacturing organizations . . . have historically relied on administrative expertise to coordinate reseller marketing efforts. Suppliers with dominant brands have predictably experienced the least difficulty in securing strong trade support, but many manufacturers with

'fringe' items have been able to elicit reseller co-operation through the use of liberal distribution policies that take the form of attractive discounts, financial assistance, and various types of concessions that protect resellers from one or more of the risks of doing business.

An example of a successful administered VMS is that of the furniture/lifestyle retailer, IKEA who has developed close working relationships with its suppliers. Acting as the channel co-ordinator, IKEA is committed to cost-effective supply and their suppliers benefit from the channel leadership of an effective and marketing-oriented retailer.

Administered VMS are one step removed from conventional marketing channels. In an administered system, co-ordination of marketing activities is achieved by the use of programmes developed by one or a limited number of firms. Successful administered systems are conventional channels in which the principles of effective inter-organizational management have been correctly applied. Before we discuss how such marketing channels are co-ordinated, it is important that we discuss their structure.

STRUCTURE OF MARKETING CHANNELS

The marketing channel has two basic aspects:

- 1 the placement of intermediary types of channel in relation to each other i.e. the order in which they occur;
- 2 the number of different intermediary levels or stages in the channel i.e. how many different separate types of intermediary are involved, so types of intermediary and number of levels determine the structure of a marketing channel.

There are several types of channel structure, dependent on the type of goods. An example of a structure for consumer goods such as food and clothing is shown in Figure 6.2. This figure is based on three assumptions:

- 1 The channel consists of complete organizations.
- 2 Manufacturers' agents and selling agents are included with the merchants even though they do not take title to the goods.
- 3 Physical movement follows exactly the movement of ownership.

We must understand the underlying reasons for the emergence of channel structures. Four logical steps can be identified:

- 1 The efficiency of the process can be increased via an intermediary.
- 2 Channel intermediaries arise to adjust the discrepancy of assortments through the performance of the sorting processes.
- 3 Marketing agencies remain together in channel arrangements to provide the routine of transactions.
- 4 Channels exist to facilitate deliveries and to avoid inventory stock-outs.

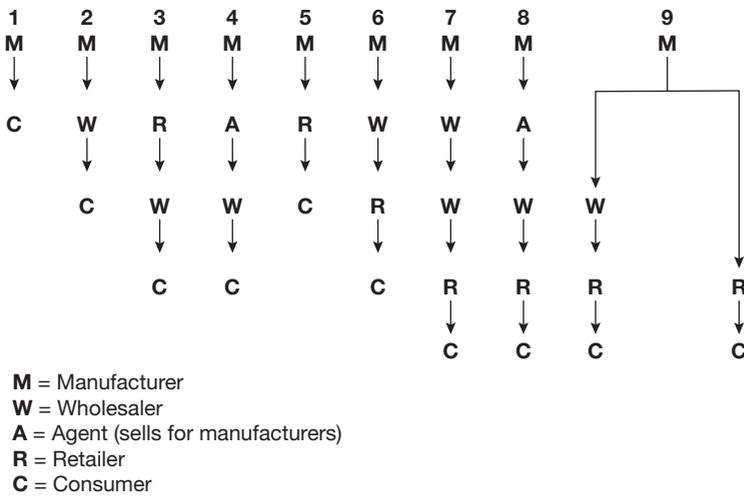


FIGURE 6.2 A typical example of structure for consumer goods

Rationale for intermediaries

As numbers of transactions increase, the need for intermediaries becomes greater. The marketing channel is a ‘canal’ which contains the physical flow of products. Because of the complex array of intermediaries operating within a channel, which may be involved in one or all aspects of channel function, the channel may also be visualized as a chain-link arrangement where each intermediary unit is effectively a link. Manufacturers are dependent on the effectiveness of their intermediaries if their channels of distribution are to meet their marketing goals.

Intermediaries of a channel specialize in more than one function. Their inclusion primarily depends on their superior efficiency in the performance of basic marketing tasks. Such intermediaries, through their experience, specialization, contacts and scale of operation, offer other channel members more than they can achieve on their own. However, this type of specialization leads to some important behavioural concepts.

Position and role

Each channel member chooses a position or location in the channel. ‘Role’ refers to the functions and degree of performance expected of the firm filling a position. Channel intermediaries perform the distribution function at a lower unit cost than the manufacturer who is the intermediary most distanced from the consumer, and they balance the production efficiencies of the supplier to the purchasing needs of the customer.

Another reason is to break down large volumes into smaller quantities, termed ‘breaking bulk’, e.g. a furniture retailer places an order for 100 tables, but the individual buys only one. When we consider the selling process, the number of intermediaries can reduce the number of transactions

contained within the selling process. See Figure 6.3. Figure 6.3 shows that there are four manufacturers and ten retailers who buy goods from each manufacturer. Here the number of contact lines amounts to 40 (i.e. 4×10). If all four manufacturers sell to 10 retailers through one intermediary, the number of contacts is reduced to 14 (i.e. $4 + 10$). The number of contacts increases as the number of intermediaries increases, e.g. when the number of wholesalers is increased to 2, contacts will increase from 14 to 28 (i.e. $[4 \times 2] + [10 \times 2]$). Thus, greater numbers of intermediaries result in diminishing returns per contact.

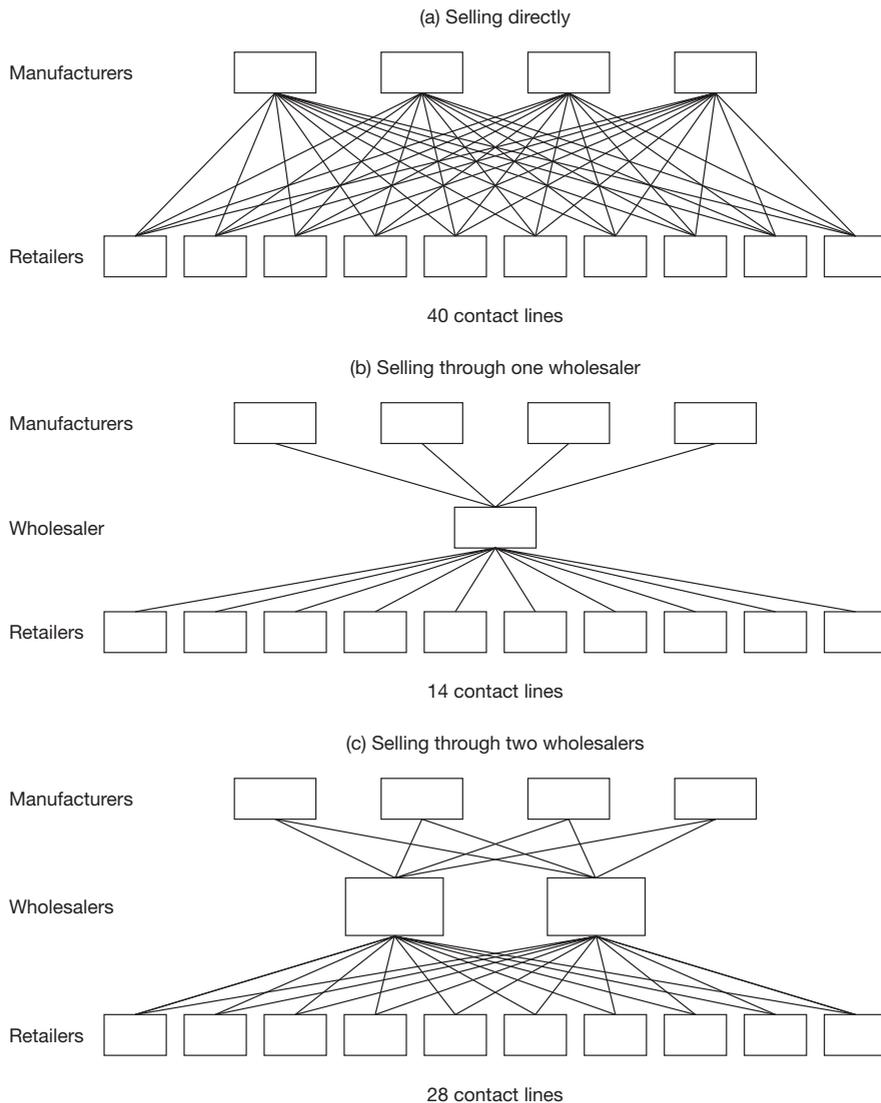


FIGURE 6.3 The economics of intermediary systems

Assortment and sorting

In addition to increasing the efficiency of transactions, intermediaries smooth the flow of goods and services by creating what economists refer to as ‘possession’, ‘place’ and ‘time’ utilities. This smoothing requires that intermediaries perform a sorting function to overcome the discrepancy that arises between goods produced by manufacturers and goods demanded by the consumer.

In addition, intermediaries bring together a range of similar or related items into a large stock, thus facilitating the buying process. A supermarket will buy in thousands of lines to provide shoppers with choice, and a builders’ merchant will provide everything from sand and gravel to light fittings that the builder can use. In this way, intermediaries play an important role in facilitating the flow of products from the manufacturer to the consumer.

Routine transactions

The cost of distribution can be minimized if transactions are routinized. In effect, through routinization, a sequence of marketing agencies is able to hang together in a channel arrangement or structure. A good example is automatic ordering, whereby the cost of placing orders is reduced when retail inventory levels reach the necessary re-order point.

Searching

Buyers and sellers are often engaged in similar activities within the marketplace. There is a degree of uncertainty if manufacturers are unsure of customer wants and needs, and consumers are not always sure what they will find. In this respect, marketing channels facilitate the searching process in two ways:

- 1 Wholesale and retail institutions are organized by different product groups; for example, fashion, hardware, grocery.
- 2 Many products are widely available from wide ranging locations.

FLOWS IN MARKETING CHANNELS

When we discuss marketing flows, there will be times when the word ‘function’ could be used, but here we refer to marketing ‘flows’ in channels as a better method of describing movement. In this way, we can show that various intermediaries that make up a marketing channel are connected by several distinguishable types of flow, summarized in Figure 6.4, which depicts eight universal flows. The figure shows that physical possession, ownership and promotion are typically forward flows from producer to consumer. Each of these moves is ‘down’ the channel; a manufacturer promotes the product to a wholesaler, who in turn promotes it to a retailer, and so on. Negotiation, financing and risking flows move in both directions, whereas ordering and payment are backward flows. Financing is the most important of these flows; at any one time, when stocks are being held by one member of the channel, financing is in operation. When a wholesaler takes ownership and physical

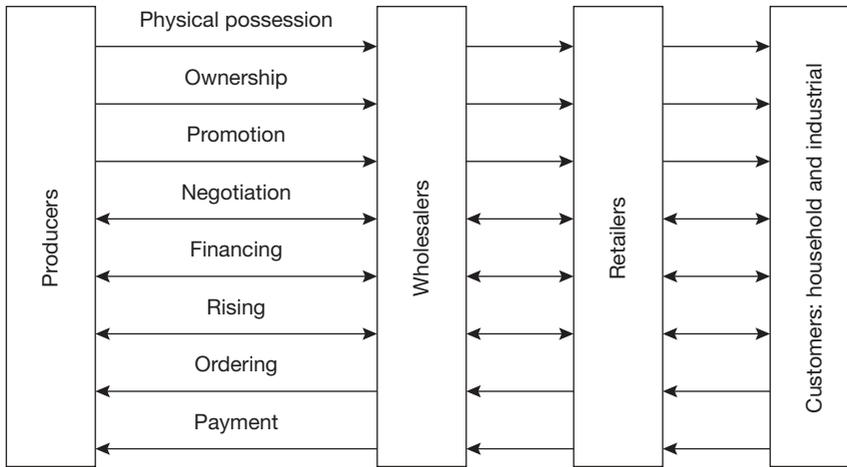


FIGURE 6.4 Marketing flows in channels

Woolly Thinking

Under the auspices of the Confederation of British Wool Textiles (CBWT), groups of British wool textile manufacturers exchange information and ideas. The Confederation is organized into distinct groups in the industry with each group representing a particular stage in the manufacturing and processing of wool. For example, there is a group representing 'Raw Fibre Producers', another representing 'Spinners', another representing 'Fabric Manufacturers' and one representing the interests of 'Dyers and Finishers'.

possession of a portion of the output of a manufacturer, the wholesaler is essentially financing the manufacturer.

This notion is apparent if the costs of stock are considered. Stock held in stores as dormant stock is 'dead money', but if this is freed via a wholesaler, this 'dead money' is available for reinvestment. The furniture industry exemplifies the flow. Traditional furniture retailers operating on a sold-order basis do not participate in the backward financing flow. However, 'warehouse type' furniture retailers participate in this flow directly, and receive benefits from manufacturers in the form of lower prices and preferential treatment. This backward flow of financing is not solely associated with stockholding, another example being prepayment for merchandise.

The problem is that in the event of any downturn in sales the warehouse type retailer with large sums of money tied up in stock is very vulnerable to cash flow and liquidity problems. To underline this, blaming the downturn in the UK housing market in July 2009, the UK's second largest carpet retailer, Allied Carpets, called in the receiver.

Forward flow of financing is more common. All terms of sale, with the exception of cash on delivery and prepayment, may be viewed as elements of the forward flow of financing. In addition to these flows there is information flow. Typically, information regarding product attributes is passed 'down' the channel, often with the dominant channel member having greater influence on this function. Marketing information is passed 'back' up the channels. In addition, information flows horizontally, i.e. with intermediaries operating at the same level, such as fibre manufacturers, communicating for mutual benefit.

CHANNEL CO-ORDINATION

However well designed a marketing channel may be it is important that it is organized and co-ordinated, otherwise activities and flows will not operate effectively, and the full potential of the system will not be realized. Emphasis should be placed on understanding behavioural dimensions of inter-organizational relationships, because through such understanding, the manager can organize, manipulate and exploit available resources.

The long-term objective of channel management is to achieve, at a reasonable cost, the greatest possible impact at the end user level, so that individual members of the channel can obtain satisfactory returns (e.g. profits, market share) as compensation for their specific contributions. The behaviour of intermediaries within any given structural arrangement should thus be directed towards achieving high yield performance.

Once the marketing management of an organization isolates the market targets to attack, and the products and services which it must supply in order to satisfy needs and wants in those various segments, the question of how best to make products and services available for consumption arises.

Figure 6.5 identifies four major steps that represent the co-ordination process. The first step is to determine the level of service outputs demanded by end users of the commercial channel system. Service outputs that are among the most significant in distribution are, for example, lot size. Some companies insist on a minimum order level. Under this limit they will not accept the order. In contrast, often smaller companies are unable or unwilling to supply orders over a certain size.

A second type of service output is delivery or waiting time, or how long it takes from order to delivery.

A third service output relates to market decentralization or spatial convenience, namely, to where the provider will deliver. For example, some suppliers will only deliver locally whereas at the other extreme some will undertake to deliver anywhere in the world.

Finally, there is breadth and depth of product or service assortment. This refers to whether or not the provider is able to supply a full range of products and services or only a selected range, i.e. a 'one-stop shopping' facility.

The second step involves identifying the marketing tasks that need to be carried out in order to achieve the service outputs, and which channel members have the capability to perform the tasks. Management must then determine whether, through the use of channel control strategies, they will be able to control the behaviour of existing channel members or be compelled to integrate channel flow vertically so the required service outputs are provided to end users.

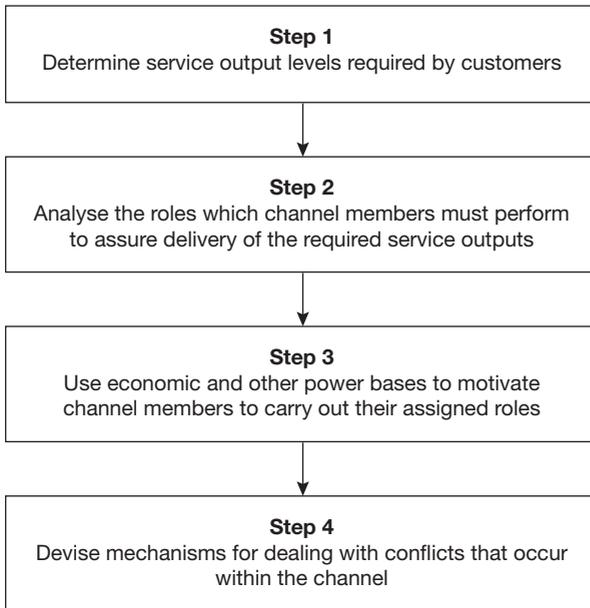


FIGURE 6.5 Stages in the channel co-ordination process

For example, if a desired level of service output is that orders must be fulfilled within five working days then the channel and logistics system must be designed to reach this service level. If intermediaries in the channel are unwilling or unable to meet this service output then alternative channel arrangements must be found. Without effective channel management and control there is no guarantee that the desired service outcomes will be achieved, so a major issue in channel management relates to where, and to what extent, marketing flow participation should be assumed to generate the desired service outputs; e.g. if a car buyer needs finance, the manufacturer, the retailer or an outside intermediary should provide it, but lending services must be readily available if the consumer is going to feel comfortable in considering a specific purchase that requires finance. In a situation where no channel intermediary is willing to accept the risk of financing, the initial supplier may have to assume this, i.e. it would prefer to specialize in those flows that it can perform at a comparative advantage.

The third step in the co-ordinative process is to determine which strategies should be used to achieve the desired results, irrespective of whether management decides to invest in integrating functions or whether it deals with independent companies. Essentially this is an issue of where and how 'power' is applied in the channel. Power is the ability to get somebody to do a task. In the context of a marketing channel it can be defined in terms of how one channel member can exert influence on another channel member. For example, due to their size and purchasing power, many retail multiples in the UK like Marks & Spencer are able to exercise substantial power over their suppliers. Power is the mechanism by which congruent and effective roles become specified, roles become realigned when necessary, and appropriate role performance is enforced. There are several bases of power, which include reward, coercion and expertise.

The fourth step involves setting up mechanisms to deal with conflict issues that may arise so that the channel will continue to provide the desired service outputs even if channel members disagree. Very often channel members perform unique roles. Thus, manufacturers specialize in production and national promotions, while retailers specialize in merchandising, distribution and promotion at a local level. This specialization means that channel members become reliant on each other to achieve objectives. There has to be co-operation between channel members, as without it, the task will not be completed. Such co-operation does not always come easy and needs to be cultivated.

CHANNEL CONFLICT

There is a danger that there will be conflicts of interest and distribution channels will exhibit levels of conflict. For example, suppliers may want to deliver weekly to a retailer, but the retailer wants to hold less stock, so may want daily deliveries. Ideally, channel members should attempt to coordinate their objectives, plans and activities with other intermediaries such that performance of the total distribution system to which they belong is enhanced. Evidence supports the view that such integrated activity throughout the length of the marketing channel is rare and channel participants are not too concerned with transactions that occur between each of the various channel links. Channel intermediaries are more concerned about dealings between channel members immediately adjacent to themselves, from whom they buy, and to whom they sell. Channel intermediaries do not function as component members of a distribution system, but operate independently, making decisions concerning their own methods of operation, functions performed and clients served as well as deciding their own objectives, policies and programmes. Therefore, a marketing channel should be a set of interlocking and mutually dependent elements and it is in the interests of all channel members for there to be a substantial degree of co-operation, but an almost inevitable feature is potential conflict between members which should be taken into account when making channel arrangements. It is possible that healthy competition can lead to conflict and management should seek ways to reduce this conflict. Conflict in distribution channels can occur in different forms as follows:

- 1 **Horizontal conflict** – is related to competition among similar types of intermediaries at the same level in the channel – e.g. two household textile stores in competition with each another.
- 2 **Intertype conflict** – refers to competition among different types of intermediaries at the same level in the channel. This kind of competition has intensified since the advent of ‘scrambled merchandising’ by retailers (where retailers add new product lines that are unrelated to their normal lines of business) e.g. supermarkets have added homewares and clothing to their product lines, offering consumers a wider product range and attaining higher margins. Intertype conflict is significant as it reflects a way in which industries remain efficient and respond to changing market conditions.
- 3 **Vertical conflict** – refers to competition among different levels in a channel. Such problems can be damaging to existing co-operative relationships e.g. in recent years some of the major car producers have been in conflict with their distributors over matters like pricing and discount policies, stockholding levels and exclusivity agreements.

Stress and conflict can be in a dormant state; times of change cause existing stress to peak, leading to hostility among channel members. Some conflict is inevitable in channels and may even be positive in that it can prompt needed changes. The earlier example regarding retailers selling manufacturers' brands at lower prices than manufacturers wish is an example of vertical conflict. Selling of brands like Levis and Calvin Klein at prices lower than those recommended by manufacturers has given rise to vertical conflict in the channel. Other examples of this type of conflict in the UK recently have been the selling of discounted books and discounted pharmaceutical products by the large retail supermarket groups.

Goal incompatibility

Channel members appear to share a common goal – maximizing the efficiency and effectiveness of the total system. However, each firm exists as a separate legal entity, each with its own employees, owners and other interested parties who help shape its goals and strategies. Some firms' goals may be incompatible with the aims and objectives of other channel members. This incompatibility can be a primary cause of stress which will ultimately result in conflict. The distribution of channel profits is a typical example. Each institution will desire the highest possible profit for the whole channel and the natural tendency will be towards co-operation to achieve maximum profit levels. However, each individual firm can be expected to desire the largest obtainable share of total channel profits. The predictable result is conflict over the allocation process.

Even if goals are compatible, there may be disagreements about methods employed: all channel members may agree that increases in volume of a product are desirable, but may disagree on the means employed to accomplish it. Wholesalers may desire more shelf space for better positioning of products in retail stores; retailers may feel that more advertising and promotional effort by the manufacturer would accomplish the objective of an increase in sales. The result is conflict over which method to use.

Position, role and domain incongruence

In a channel consisting of a manufacturer using only wholesalers who sell to retailers, there will be a realignment of the roles and domains of each party. By serving large retailers direct, positions will be re-specified. Changes in position specification, or poorly defined positions, can precipitate conflict among channel members, so the manufacturer must anticipate and understand the expected behaviour of such members. In situations where consensus does not exist, conflict can be expected.

Because each role represents a code of conduct defining the channel member's expected contribution, adequate performance is critical to maintaining harmony within the channel system. Inadequate performance, or failure to behave in the prescribed manner, frustrates attempts by one firm to predict what the other will do and such frustration is a major cause of channel conflict.

Conflict may also arise when there is lack of agreement concerning who is the channel leader (termed the '**channel captain**'). If channel members disagree on the domain of firms in the system, there will be conflict and an inability to achieve goals. If domains overlap, and two or more firms lay claim to the same functions, products or customers, disagreement might lead to hostility. The conflict between car producers and their distributors just described, in part stems from the issue of

who controls the channel. In the past it has been the car companies who have been channel captains but market and legislative changes have shifted the balance more towards distributors, giving rise to conflict.

Communication breakdown

Communication breakdowns may cause conflict in two ways:

- 1 The failure of one firm to pass on vital information to other channel members. A manufacturer wishing to maintain a competitive advantage may decide not to announce a new product until a national distribution programme has been developed. Retailers, on the other hand, need information about new products as soon as possible to prepare their own strategy for the introductory period.
- 2 Distortion within the message process is called 'noise' that often arises from confused language nuances. When channel members attach different meanings to language and terminology (e.g. if their roles are unclear and confused) stress results and there is potential for conflict. Speculation surrounding the health of Apple boss Steve Jobs caused problems for the company and its distributors. In January 2009 the annual MacWorld conference normally used to announce new products and developments was cancelled. This caused speculation in the trade about whether or not Jobs would continue. The problem was not so much Jobs' illness but rather the rumours about it. In July 2009 it was announced that Jobs was making a good recovery from a liver transplant.

Communication breakdowns are common in specialist business areas. Noise arises when functional specialists develop terminology that means little to those outside that business environment. Unclear communication with non-specialists can play a part in developing conflict so the specialist should ensure that communications have been understood.

Differing perceptions of reality

Different solutions to mutual problems can lead to conflict behaviour. Even when channel members have a strong desire to co-operate and goal agreement exists, conflict can occur when perceptions of the real facts differ.

Bare Bellies Update

Dear all, further to my e-mail yesterday, I've had clarification that a new system for producing bare belly information will be in place. Please note there will no longer be blank bare belly sheets available in departments. Confused? So was this organization's staff who received this e-mail.

The e-mail was from the organization's publicity department and was sent to all staff. 'Bare bellies' is a term used by printers to denote blank sheets to be printed on. The e-mail related to the production of company promotional material.

Each channel member brings to the relationship different backgrounds and prejudices; facts are likely to be interpreted according to prior experience. All members may agree that the channel is not functioning as effectively as desired; each channel member may perceive a different reason for this lack of effectiveness. Manufacturers may feel that a retailer's lack of stock is due to failure to maintain adequate safety stock levels and realistic reorder points. The retailer may feel that inventory policies are realistic and that the problem is caused by the manufacturer's inability to meet scheduled delivery times. Each party is interpreting the situation based upon experience and natural prejudices associated with its own position and role.

Ideological differences

Sometimes there may be a fundamental ideological conflict in channels which stems from big business and small business perceptions of management, particularly concerning the appropriate level of sales effort. For example, a manufacturer may be so satisfied with the performance of a wholesaler in a given territory that pressure is exerted on the wholesaler to expand the line of products on offer, whereas the wholesaler may be satisfied with allowing the business to continue to run in its present form.

In this way, pressures exerted by the manufacturer will lead to stress and conflict in the relationship. If this is an established channel, it is in the interests of everybody to settle the dispute or misunderstanding quickly.

There are several methods of resolving conflict, and it is a task of management to seek ways in which to manage it to avoid it becoming dysfunctional and to harness the energies in conflict situations to produce solutions. Depending on which underlying cause is identified, different strategies can be employed in isolation. Another important factor in the resolution of the conflict will be the weight of power of the channel member seeking to resolve the conflict.

Problem solving

Adopting **superordinate goals** is a method that refers to goals that are desired by all members caught up in the conflict. Often such goals cannot be achieved by individual channel members, as concerted efforts of all parties are required. Such disputes become more pronounced when the channel is confronted by an external threat, and conflict only dissipates when alternative channel systems emerge.

The threat to existing channel members of new channel arrangements for car retailing in the UK has brought about a reduction in conflict between traditional channel members. Car manufacturers and dealers were challenged by the fact that consumers were increasingly purchasing new cars through a variety of new channels including sourcing them from countries where prices might be lower, the growth of 'car hypermarkets' where cars are sourced on the 'grey market' and through the Internet. The result has been for existing traditional channel members to adopt superordinate goals and this has resulted in a reduction of conflict between them in an effort to survive.

Permanent conflict resolution requires an integration of the needs of both sides to the dispute so they find a common goal without sacrificing their basic economic and ethical principles. The problem is developing a common goal on which all parties agree.

A solution exists to alleviate **communications noise** in distribution channels. A more efficient flow of information and communications in channels permits members to find solutions to their conflict based on common objectives. Channel communication efforts should be designed to decrease or avoid conflict, e.g. using sales representatives to convey information from wholesalers or retailers implies that the manufacturer is trying to encourage the attainment of both individual and common goals; the function of the sales representative in such cases is that of 'problem solver'.

Persuasion

This implies that institutions involved draw on their leadership potential. If effective channel management is to be achieved, it is often the case that there will be a need to locate an institution or an agency within the system that is willing to assume this role. Channel leadership is the intentional use of power to affect the behaviour of other channel members and cause them to act in a manner that contributes to the maintenance or achievement of a desired level of performance. Often channel control results from channel leadership and like channel power, the level of control achieved by one firm over others in a channel may be issue specific, e.g. while the manufacturer may have control over pricing, retailers may have control over stock levels. Whether or not control can be exerted depends on the power base of each channel member.

By its nature, persuasion involves communication between conflicting parties. Emphasis is on influencing behaviour to resolve conflict; the primary intention is to avoid or reduce conflict concerned with domain or sphere of influence. Persuasion allows members to reach a consensus resulting in agreement without formal bargaining.

Some years ago a well-known company launched its own brand of cola. The new brand was eagerly stocked by many leading grocery supermarkets who were persuaded to make space for the new brand on their shelves. Inevitably this meant less shelf space for existing brands including some of the best known cola brands in the world. As if this loss of shelf space was not bad enough, the world's leading cola brand claimed bitterly that at first glance the new Virgin cola looked remarkably like their own cola brand. They subsequently asked Virgin to withdraw the new brand in its present form and at the same time asked their supermarket customers not to stock it. Needless to say, there were protracted discussions, but after a little time all parties were persuaded to come to a compromise which avoided costly litigation and loss of face. The new cola was altered slightly in appearance, some of the lost shelf space was restored and the new brand gradually made inroads into the market.

Bargaining/negotiations

The difference between bargaining and persuasion is that in the bargaining process stress continues to exist in the system long after agreement is reached. In negotiation, no attempt is made to fully satisfy a channel member. Instead, the objective is to reach an 'accommodation' to stop conflict among members. Such a compromise may resolve the episode, but not necessarily the fundamental stress over which the conflict erupted. If stress continues, it is likely that some issue will cause conflict again at some later date.

Compromise is a means by which bargains can be reached in the channel. Each party gives up something it desires to prevent or end conflict. Often compromise is necessary to reach domain consensus where persuasion and negotiation draw on abilities of parties involved to communicate.

Politics

Politics refers to resolution of conflict involving new organizations in the agreement-reaching process. Mediation involves a third party, usually to secure settlement of a dispute by persuading the parties to continue negotiation or consider recommendations made by the mediator. Mediation involves understanding the conflicting views of parties in such a way that opportunities are perceived that otherwise may have been missed. The fact that solutions are being offered by a mediator, i.e. somebody external to the dispute, can often lead to a settlement if both parties deem the solutions acceptable. Effective mediation keeps the parties together and clarifies facts so the communication process does not break down. While mediation offers solutions to disputes, channel members are not obliged to accept the solutions.

In arbitration, however, the solution suggested by the third party is binding upon the conflicting parties. Arbitration can be compulsory or voluntary, and when it is the former, parties are required by law to submit their dispute to the third party and be bound by the decision. Voluntary arbitration is a similar process whereby parties are bound by the decision, but the dispute is settled voluntarily.

The question of relying on law enforcement to settle disputes in distribution is imprecise as it is doubtful whether solutions enforced by law can be applicable to future channel disputes in different circumstances. In purely domestic channel management, these mechanisms are not greatly used because of the inability to find a neutral third party whose decision will be accepted by everybody involved in the dispute. However, arbitration is a normal and accepted part of international channel management and is part of the contractual agreement between the parties in channel activities. For example, if an exporter feels that an overseas agent has not fulfilled the terms of an agreement between him or herself and the principal, but the two parties cannot agree as to the remedies for this, then normally the terms and conditions for instituting an arbitration process are written into the original contract and will be instituted to resolve the problem.

Diplomacy

Channel diplomacy is the normal method by which inter-organizational relations are conducted, adjusted and managed by 'ambassadors', envoys or other persons operating at the boundaries of member organizations. Normally channel members rely on diplomatic procedures, especially in non-integrated systems. Channel diplomats should be the 'eyes and ears' of the firms they work for, and should report anything that may be of interest. Such 'diplomats' are commonplace in distribution channels at executive level. In this way, the diplomat's power base is such that it is obvious to the parties with whom the diplomat will interact. Effective channel management strategies provide for more rational decision making within the channel.

THE DYNAMIC NATURE OF CHANNELS

Marketing is characterized by constant change, and there is a need for the marketer to adapt to these changes, making marketing channels subject to change and innovation. Channels represent a

dynamic area of marketing as they are constantly evolving to meet changing customer and market needs which reflect underpinning wider changes and trends in demography and lifestyles. Marketers must be aware of the changing nature of channels and respond to them. An example of recent developments that are indicative of the innovation and changing nature of this area is the growth of **multi-channel systems** of direct marketing and Internet marketing which are dealt with in Chapter 10.

The growth of multi-channels

Companies now use a variety of channel arrangements to reach their target customers. Once, companies tended to use only one type of channel configuration in their marketing; now they use several. The use of multi-channel systems can be for a number of reasons:

- to increase market coverage by reaching new customers;
- to reduce costs of selling to certain customers where for example such customers require less service than that provided through the company's normal channels;
- to achieve a more customized service to particular customers than would be available through the company's normal channels.

In multi-channel marketing, a company might sell to one group of customers using telephone selling and no intermediaries, while another target group may be marketed to through a network of dealers, since these customers require after-sales service and technical advice.

Although there are advantages to be gained through using several different channel configurations to different target customers, multi-channels can give rise to increased costs if not controlled. They can also give rise to problems of conflict between different channel members where several channels are used, particularly where one type of channel member feels that their contractual rights are being infringed. An example is where the marketer uses a system of 'appointed' distributors for the company's products. In return for being granted 'exclusive' distribution rights in a particular geographical area a retailer may enter into a formal agreement with a supplier. In exchange for these 'exclusive' rights, the dealer may agree not to stock and supply other competitive brands.

Unsurprisingly, 'exclusive' dealers feel aggrieved if they find that the brand they have been appointed to sell in a given area can be purchased direct over the Internet often at a price the dealer cannot hope to match.

Growth of direct channels

As Chapter 10 discusses the growth of direct marketing, suffice to say here that besides being an element of the promotional mix, direct forms of marketing can be considered as sales channels. Clearly, the growth of direct marketing methods such as catalogue selling and direct mail are examples of developments in channels as well as promotion. In addition to direct marketing channels, another key area of growth in direct distribution is the development of home shopping mainly through the Internet.

Internet channels

The Internet has brought about significant changes to existing channels e.g. traditional booksellers, travel agents and record stores have had to cope with major changes in how customers purchase.

Jeff Bezos founded Amazon in Seattle in 1994. It started as an Internet bookseller and shocked traditional retailers. From virtually nothing, Amazon built substantial sales in a very short space of time. Without having to support expensive retail outlets, Amazon was able to undercut the prices of conventional book retailers. The company added the facility for buyers to write their own book reviews. People began to look at Amazon as more of an on-line community and not just a place to make purchases. Amazon diversified into DVDs, video games, toys, clothing, beauty products, household goods and other items.

Mail order shopping at home has been around for a long time. In 1744 Benjamin Franklin formulated the basic mail-order concept in the USA when he produced a catalogue selling scientific and academic books. New forms of home shopping take this concept of selecting goods at home and ordering further. Access to cheap computing power at home has enabled marketers to develop systems of real time shopping where customers call up descriptions and pictures of products on their computer screen, search through computer-based catalogues, and order and pay over the Internet through charge cards. Virtual reality shopping is now commonplace where the home shopper calls up the shopping mall onto their screen and moves to different selected outlets, taking trips down different aisles in the retail outlet, and even selecting products from the 'shelves' for closer inspection. The customer places an order through the Internet and has it delivered. Large supermarket groups offer such facilities.

A fast growing area of home shopping has been shopping channels on the television. Cable television in particular has fostered this growth; in the United Kingdom many television companies have a shopping channel where customers view products and services and buy direct using only the television, a credit card and the telephone. Home shopping is advantageous for the elderly and infirm and it is likely that this type of retailing will continue to grow. As Ozuem, Howell and Lancaster² conjecture:

Marketing communication is in need of reinvention in respect of its key concepts, methodologies and prevailing procedures to ensure their appropriateness for the evolving global interactive market-space. This is a challenge for both theoreticians and communications specialists.

PHYSICAL DISTRIBUTION AND LOGISTICS

We switch our emphasis away from the more abstract concept of channels, towards more practical issues that were, until recently, undeveloped aspects of marketing and corporate strategy; namely, the physical flows of products, services and information into, through and out of the organization to its customers. Physical distribution and logistics are part of the 'place' element of the marketing mix and these have had a major impact on channel strategy and design. Effective management of physical distribution and logistics has a substantial impact on a company and its customers' costs,

efficiency and effectiveness. If these are well planned and implemented, they are competitive tools that can build sustainable competitive advantage. A total **systems approach** to physical distribution i.e. the science of moving items from production to consumption in a timely, economical manner, is referred to as logistics.

Reasons for increased attention to this function are the result of a continued search for cost savings in distribution and stockholding. Much research for cost savings has centred on the production area. Labour-saving technology, replacement raw materials and effective production planning have accounted for considerable effort being made to reduce costs and improve output. This has meant that increasingly the potential for further cost savings in these areas has become limited. If management is going to continue to look for cost savings it has to look elsewhere.

Lancaster³ suggests that distribution and stockholding costs can add 25 per cent to direct materials costs. Unsurprisingly, in the search for further cost efficiencies in companies, physical distribution and logistics have figured highly. It has become increasingly clear that not only is there substantial potential for improving efficiency and reaping cost savings, but more importantly for the marketer, this area offers substantial potential for developing sustainable competitive advantage.

Part of the explanation for neglecting research in this area lies in the fact that conventionally individual elements of physical distribution and logistics have been dealt with in a fragmented manner, with separate parts of the business incurring what appeared to be relatively small costs of distribution. As a consequence, information on total costs has not been available or has 'disappeared' in the accounting system. Some of the major costs of physical distribution have accelerated. A major element of cost is transport, which is increasingly expensive as road, sea and air networks have become increasingly congested. Similarly, increases in fuel prices have contributed to increased transportation costs.

The emergence of a total systems (logistics) view of distribution is based on analogies and ideas drawn from the military. It became recognized that effective distribution depended on **logistics**, or an integrated approach to elements which help move products and services to the right place, in the right quantity and at the right time. It was recognized that 'optimizing' one part of the system, e.g. inventories of stocks and work-in-progress, might have a detrimental knock-on effect on other parts of the distribution system, thereby reducing the effectiveness of the system as a whole. Such systems thinking is an essential component of modern logistical management. Systems thinking applied to distribution has proved a powerful impetus to the importance of this area.

Alongside the development of the total systems approach to distribution has gone the development of more sophisticated and powerful tools of analysis. The notion of interrelationships in the total system of distribution makes the problems of managing it difficult and complex. Developments in modelling, allied to more powerful computer power, have enabled this complexity to be managed. We now have the tools to handle logistics through IT.

The main reason for the growth in importance and interest in physical distribution and logistics is the fact that the logistics system offers substantial potential for achieving a competitive edge and winning and keeping customers. Particularly in industrial markets, where products may be relatively undifferentiated and margins are slender, companies find they can gain a competitive edge by using their logistical system to improve customer service levels and this might be critical in terms of customer choice. This may allow a company to increase volumes of sales and/or increase prices. Because of this, identifying appropriate levels and types of customer service to be achieved by the logistics management system is a key aspect of planning in this area.

Developments and trends in manufacturing and purchasing have heightened the importance attached to the service elements of the logistics systems of suppliers. This was discussed in Chapter 2 when we considered organizational buyer behaviour. With modern continuous flow and large batch manufacturing systems a stock-out situation of a minor and inexpensive component may incur substantial costs in down time. This problem is heightened where a firm's customers have moved towards the implementation of 'lean manufacturing' purchasing and production. These developments in manufacturing and purchasing are so important that they need to be considered in more detail.

Perspectives on what constitutes an effective production process in a company have undergone considerable changes, which have been as a result of increased competition and more demanding customers. One of the major implications of these factors has been the recognition that production needs to be built around flexibility, while at the same time achieving cost efficiencies and consistent quality of output. Lancaster⁴ suggests this flexibility of the production process is essential because:

It transforms production operations enabling one machine to produce a wide variety of models and products – it provides the corporate capability to produce more varieties and choices even down to offering each individual customer the chance to design and implement the 'programme' that will yield the precise produce, service or variety that is right.

Amongst others Womack⁵ termed these new production processes '**lean production**' – fundamentally different from traditional mass production processes developed by Ford in 1913. Bolwijn and Kumpe⁶ suggested that this new production was part of an overall change in world manufacturing during the 1990s. They describe a number of manufacturing developments over the past 40 years. The first stage of development was based on the notion of the *efficient firm* where cost and price was all important. The emphasis was on producing competitively priced products on a mass-production scale. As a result of increasing competition, the end of the 1960s saw the need for the *quality firm* which was the next development in the evolution of production and where quality specifications were strictly applied in the manufacturing process. The third development was the transition to the *flexible firm*. This phase involved a distinct change in the production process with flow production and small batch runs of a wide assortment of products operated by teams of multi-skilled employees. Increasingly, companies have turned to this new form of flexible lean production based on flexible cells and working arrangements. Accompanying this growth of lean manufacturing has been the introduction of '**Just in Time**' (JIT) systems of manufacturing and purchasing. First used extensively in Japan, JIT took time to make inroads into the West. As the term implies, in the context of manufacturing and purchasing, JIT is based on a company securing supplies of raw materials and components needed for the manufacturing process at the precise point in time when they are required to enter this process. Dion *et al.*⁷ defined JIT as:

An inventory control system which delivers input to its production or distribution site only at the rate and time it is needed. Thus it reduces inventories whether it is used within the firm or as a mechanism regulating the flow of products between adjacent firms in the distribution system channel.

The JIT approach contrasts with the more conventional approach to stockholding delivery and manufacturing which was based essentially on the *just in case* principle. Oliver⁸ provides a comparison between Just in Case and Just in Time approaches in Table 6.1. Implications of the introduction of JIT/lean manufacturing systems for the marketer have been wide reaching. In the context of logistics, successful servicing of customers using a JIT system fundamentally alters the design and operation of the logistical process. For example, to be successful needs precise synchronization from supplier right through to production units to retailers to consumers. In turn, this synchronization requires a complete exchange of information, so the supplier is fully aware of raw material deliveries and the need for component deliveries to manufacturers. Manufacturers need to know that they will receive deliveries at the right time. Lynch,⁹ using the Dell case analogy, has shown how JIT systems require close contact between suppliers and customers. Increasingly, this contact and the exchanges of information involved utilize computer linkages.

Womack *et al.*¹⁰ have shown that at a consumer level this system can work through retailers who provide information to manufacturers in two forms: firm orders and tentative orders. Working

TABLE 6.1 Just in Case versus Just in Time

<i>Issue</i>	<i>Just in Case</i>	<i>Just in Time</i>
Official goal	Maximum efficiency	Maximum efficiency
Stocks	Integral part of the system	Wasteful: to be eliminated
Lead times	Taken as given and built into production planning routines	Reduced to render small batches economical
Batch sizes	Taken as given and economic order quantity is calculated	Lot size of one is the target because of flexible system
Production	Various means – MRP (Manufacturing Resources Planning) models	Centralized forecasts
Planning and control	Existing system and optimizes within it. Information 'pull' for hot orders	In conjunction with local pull control
Trigger to production	Algorithmically derived schedules. Hot lists. Maintenance of sub-unit efficiencies	Imminent needs of down-stream unit via Kanban cards
Quality	Acceptable quality levels. Emphasis on error detection	Zero defects. Error prevention
Performance focus	Sub-unit efficiency	System/organization efficiency
Organizational design	Input-based; functional	Output-based; strategic
Suppliers	Multiple, distant, independent	Single or dual sourcing. Supplier is extension of production

through retailers in this way and ascribing more importance to firm orders, means the company can respond closely to customer needs and changes in the market. Thus, in the volume car market in Japan, nearly all cars are made to orders taken in the distributor's showroom and lead times are as low as ten days. A study by Frazier *et al.*¹¹ suggests that in fact some distributors have realized that sharing strategic information with suppliers can be a powerful competitive weapon helping to reduce supply uncertainties and reduce risks

These trends towards lean manufacturing are indicative of the recognition of cost savings associated with elements of logistical processes including stocks of raw materials, work-in-progress, stock-outs and problems of defective components. The result of these factors is that effective supply and the logistical systems on which this is based – logistics – are now key factors in supplier choice in industrial markets. Table 6.2 is taken from a study by Perreault and Russ¹² and discussed in Hutt and Speh.¹³ They found that when a stock-out notice for a product was received, purchasing managers switched to another supplier 32 per cent of the time. Over a 2-year period, 50 per cent of purchasing managers stopped using a supplier because of slow or inconsistent service. They investigated what happens if a rush order is not acted upon by the supplier and found that after one such inaction 42 per cent of purchasing managers would change suppliers. If this problem persisted, 54 per cent would change suppliers.

This study indicated that logistics was big on the list of supplier evaluation criteria, ranking second only to quality. Another implication is the need for closer working partnerships between suppliers and customer (Manna¹⁴). In a study based on the automotive supply industry, Jayaram *et al.*¹⁵ suggest that building close relationships with key supply chain partners is essential in order to be competitive. This underpins the importance of Relationship Marketing to which we return to in Chapter 9.

A company at the forefront of developing Just-in-Time techniques in its relationship with suppliers is the Toyota Motor Company. Toyota has over the years built up close relationships with its component suppliers, many of whom are, as a result of these close relationships, actually sited

TABLE 6.2 Importance of logistics in how purchasing managers evaluate suppliers

<i>Supplier characteristics</i>	<i>Importance ranking</i>
Product quality	1
Distribution service	2
Price	3
Supply management	4
Distance to supplier	5
Required order size	6
Minor/small business	7
Reciprocity	8

next to the Toyota production units that they supply. Toyota was one of the first companies to recognize that effective supply chain management could be a key factor underpinning competitive success.

The nature of physical distribution and logistics

At its simplest, the subject of **physical distribution** and logistics can be defined as having the right quantity of an item, in the right place, at the right time. In marketing terms we could add: at the right price, as discussed in Chapter 5.

This description of physical distribution and logistics belies the complexity of decisions and planning in achieving these objectives. Defining this business activity in this way does not provide guidance as to how to manage it. As we have seen from the importance attached to logistics, physical distribution and logistics are not passive tools. They can be important demand creators (as well as customer losers). Product availability, prompt delivery and efficient and accurate order processing

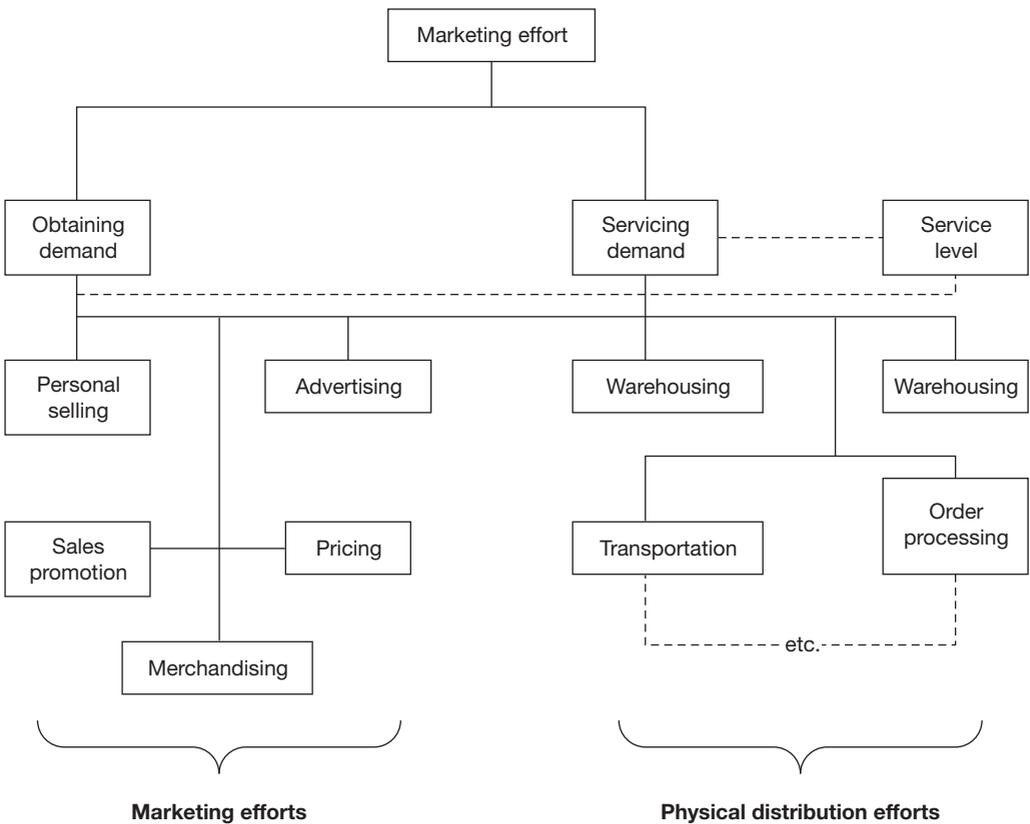


FIGURE 6.6 The demand-creating role of physical distribution efforts

Source: Adapted from Ballou, E.H. (1987), *Basic Business Logistics*, 2nd edn, Upper Saddle River, NJ: Prentice-Hall.

help to capture and keep customers. Determination of the nature and level of physical distribution service elements is crucial to effective planning of this area if it is to be used as a demand-generating tool. According to Ballou¹⁶ physical distribution and logistics can be considered in the same way as product, price and promotional elements of the mix as shown in Figure 6.6.

Some of the elements that comprise physical distribution can be used through service levels to influence demand as shown. There are others. Before examining these elements that contribute to customer service, we need to clarify the distinction and relationships between the terms we have used interchangeably; namely physical distribution and logistics. To explain the business meaning of the latter term, we need to introduce the concept of materials management.

‘Physical distribution’, ‘logistics’ and ‘materials management’ are often used as alternative terms when discussing flows of materials into, through and out of an organization. Although they are interrelated, the scope of each of these terms together with their interrelationships is shown in Figure 6.7.¹⁷ Physical distribution relates primarily to those elements that facilitate the flow of materials from the company to its distributors, retailers, final customers or all three. **Materials management** is primarily concerned with elements that facilitate the flow of goods and raw materials into and through the organization. Business logistics encompasses all of these in a total systems view of the ‘place’ element of marketing.

The term ‘system’ is used to denote the fact that all elements need to be integrated and planned as a whole to achieve specified objectives. We return to the implications shortly, but we see that the most comprehensive and useful term for planning and co-ordinating the place elements of marketing is business logistics, and we use this term throughout the rest of our discussion. It is

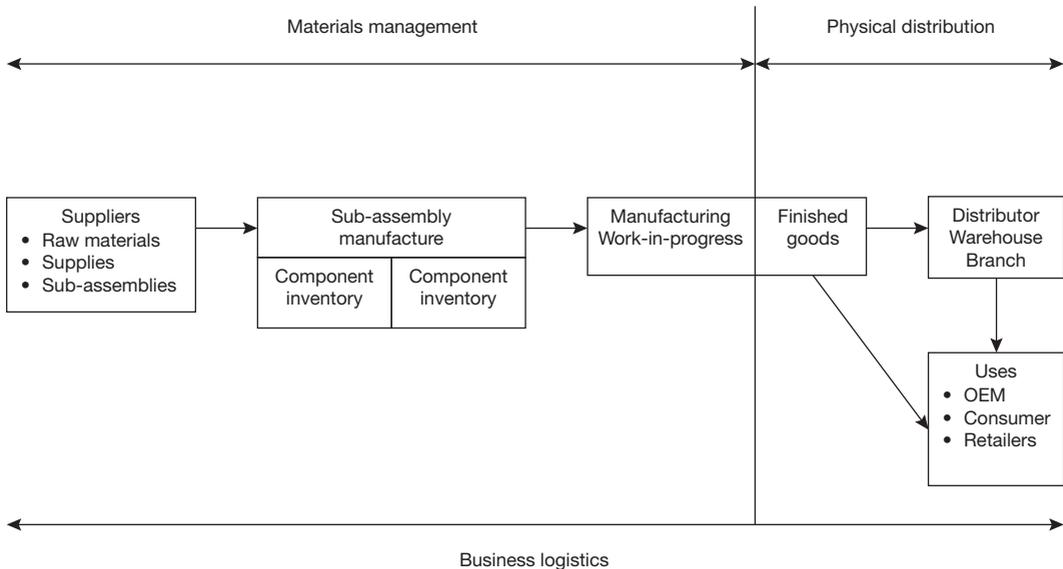


FIGURE 6.7 The relationship between materials management, physical distribution and logistics

Source: Firth, D. (1988), *Profitable Logistics Management*, Ryerson, Canada: McGraw-Hill.

important to stress that in addition to the physical flows of materials into, through and out of the organization as shown in Figure 6.7, a business logistics system includes flows of information and planning and decision-making systems; e.g. sales forecasting is an important information and planning input to the logistics system as are order processing procedures, production scheduling and planning and quality control. We can now define business logistics as follows:

A total systems approach to the management of all those activities required to acquire, move and store raw materials in process inventory and manufacturing inventory from the point of origin to the point of the end user or consumer.

Implications of the total systems approach

Before considering the design and planning of the business logistics system and its relationship to marketing strategy, we need to consider some of the major implications of the total systems approach to business logistics.

Complexity

The first and most obvious implication is that the web of interrelationships it introduces poses considerable problems in its planning and management, particularly when trying to optimize the performance of the system. This is a reason why the growth of business logistics has been dependent on the development of appropriate IT tactical planning tools.

Trade-offs between elements

A second implication is that in trying to optimize the performance of the total system we are confronted with trade-offs between the different elements; attempts to optimize performance of one part of the system without regard to the other elements tends to result in lower performance for the system as a whole. We might have to trade off optimum performance in one element of the business logistics system to optimize overall performance, e.g. where we try to minimize the costs of holding raw materials inventory by cutting down the stocks, if we cut these too far, we might find that the effect is to increase costs elsewhere in the system such as losing production through stock-outs and being unable to fulfil customer orders. As shown in a study by Shang *et al.*,¹⁸ if designed effectively, the system should be able to both reduce operating costs and at the same time increase customer service, clearly a very powerful competitive combination.

Effective co-ordination and organization

Related to complexity and trade-offs is the need in a systems approach for individual elements to be effectively coordinated and planned. Rarely are organizations structured in a way to achieve this. The far-reaching nature of the elements of the business logistics system invariably means it cuts across functional boundaries such as marketing, production, purchasing and finance. Some companies have distribution managers whose responsibilities are limited to duties like route scheduling, fleet

purchasing and maintenance. Fewer have a manager in charge of physical distribution activities both into and out of the company and another responsible for materials management. Fewer still have a department responsible for all business logistics. As better logistics systems are developed, this number is likely to grow.

Potential for conflict

The trade-off element and the need for effective co-ordination and organization mean that implementing and managing business logistics can give rise to conflict between different functions in the system. In turn, this means there must be systems and mechanisms for reducing and resolving such conflict. One approach is to install a manager with line authority over functions affecting the overall efficiency and effectiveness of the system. In addition, the system will require the establishment of operating rules and policies to guide decisions in different parts of the system. These should cover aspects like re-order levels, purchasing procedures and customer service levels.

Need to incorporate relationships outside the organization that affect the system

The implication of the systems view of business logistics is that it must be planned and co-ordinated, taking account of relationships outside the organizational system that affect planning and effectiveness. In systems terminology the business logistics system is an 'open system'. Of particular importance to its design and management are suppliers into the system; intermediaries (i.e. channel members) and at the other end, customers.

The growth in importance of logistics planning, together with the increasing complexity and specialist skills required to develop these plans, has led to the development of specialist logistics companies. An example is Tibbet & Britten, one of the market leaders in logistics planning who plan and execute a complete logistics system for client companies. Increasing numbers of companies, including the major supermarket groups, use outside specialists for their logistics. A company like Tibbet & Britten takes responsibility for all facets of distribution chain management, from planning to delivering products in a fleet of trucks to the customer's warehouse, and in the case of retail customers from warehouses or depots to individual stores.

DESIGNING AND OPERATING A BUSINESS LOGISTICS SYSTEM: MARKETING STRATEGY IMPLICATIONS

Having established the need for business logistics, we turn our attention to the design and operation of the system. Strategic marketing should be managed to gain maximum competitive advantage. However, planning, operation and control of business logistics is not a responsibility of marketing management. Its design and operation should be the responsibility of a business logistics or distribution manager. Managing business logistics includes how to calculate **economic order quantities (EOQ)**, warehouse location models and identifying cost points which are often included in marketing

texts, but these are not the task of marketing. Nevertheless, the overall design, implementation and control of a business logistics system needs to start with the output of the system and what we want to achieve in this respect. The output of the system is customer service, and it is around customer needs for service that we need to start to design the 'optimal' system.

Starting with customer needs; the service output

In a marketing-oriented company, adoption of the marketing concept should commence with the design of a business logistics system by identifying the types and level of service from the system that customers desire and are willing to pay for. Starting with customer needs is not only consistent with a marketing-oriented approach that should pervade all business decisions, but also recognizes logistics as being a 'demand generating' tool.

When we consider service outputs from a business logistics function, we tend to think of factors such as speed of delivery, reliability of delivery and goods being delivered that are undamaged. These are important elements of customer service, particularly with the growth of lean manufacturing. However, there are a number of elements of customer service which the design and running of the business logistics system can affect. Firth¹⁹ lists those shown in Table 6.3. Ballou²⁰ on the other hand, identifies possible service elements at the 'pre-transaction', 'transaction' and 'post-transaction' stages, as shown in Table 6.4. Pre-transaction elements are associated with establishing good relationships with customers, e.g. written policy statements regarding delivery and associated conditions can be provided for every customer inquiry or when the order is initially received. This covers aspects such as ordering and delivery and procedures for sending goods back. In this way, customers know precisely what they are getting in terms of logistical service. Transaction elements are those that are directly concerned with delivering the product to the customer, and affect things like lead times and order accuracy. Post-transaction elements affect the logistics support a customer receives after purchasing the product, and include elements of service such as return of faulty products, complaints and warranty provisions.

TABLE 6.3 Common measures of customer service

- Order cycle time
- Consistency of order cycle time
- Availability of product
- Order status information
- Flexibility to handle unusual variations
- Returns – damaged and surplus goods
- Response to emergencies
- Freedom from errors

Source: Firth, D., *Profitable Logistics Management*, McGraw-Hill, Ryerston, 1988.

TABLE 6.4 Elements of customer service

<i>Pre-transaction elements</i>	<i>Transaction elements</i>	<i>Post-transaction elements</i>
Written statement policy	Stock-out level	Installation, warranty, alterations, repairs, parts
Statement in hands of customer	Ability to back order	Product tracking
Organizational structure	Elements of order cycle	Customer claims, complaints
System flexibility	Time	Product packaging
Technical services	Transhipment	Temporary replacement of product during repairs
	System accuracy	
	Order convenience	
	Product substitution	

Source: Adapted from Ballou, E.H. (2003), *Business Logistics Management: Planning, Organising and Controlling the Supply Chain*, 5th edn, Englewood Cliffs, NJ: Prentice-Hall.

In addition to service elements, individual industries and individual customers may have their own special service requirements. The strategic marketer must constantly search for innovative logistics service features that can provide a new competitive edge. Federal Express, Avon and the retailers B&Q and Argos are examples of companies that have carved out a profitable position in the market through innovative logistics programmes designed to give additional customer service. To illustrate how the business logistics system potentially impacts on customer service, we consider an example of one aspect of logistics service level, order cycle time, and illustrate how this might relate to some of the elements of the business logistics system and their design and management.

Order cycle and time (lead times)

We feel frustration when having selected a product and a supplier, placed the order and paid a deposit, we then have to wait weeks for delivery. Because of this, the length of time that elapses between an order being placed and the customer receiving the product or service (i.e. the lead time) can be a crucial element of customer service, especially in industrial markets. Decreasing order lead times is a source of competitive advantage. Say the average lead time in an industry is five days; determining that by decreasing this to two days would mean a significant competitive edge

(i.e. customers would value this) what elements of a business logistics system might we potentially look to for us to decrease order lead time? There are areas we might consider to achieve this objective:

- *Inventory levels:* We might seek to decrease order lead time by only keeping limited or possibly no stock; if we only produce to order, then clearly the order time is increased by at least the length of time of the manufacturing cycle. We can simply decrease order lead times by increasing inventory at appropriate points in the logistics system. This might be done at factory, wholesaler or retailer levels, or all three.
- *Order transmission:* This affects order lead times through the length of time it takes for the supplier to receive the order. IT developments in business communications have made this less of a problem, but at the very least we need to ensure that there are no unnecessary delays in our receiving the order.
- *Transport:* In relation to the mode and organization of transport used to deliver products to customers we might look to faster modes of transport, e.g. air freight instead of road, or we might increase the size of the fleet, or re-plan delivery routes.

Many companies have developed systems for reduced lead times. Benetton for example have a system that enables them to gather data from their franchised outlets on a continuous basis with regard to what is selling. This data is analysed overnight and translated into a production schedule based on which products, colours, etc. of garments are selling. Benetton holds stocks of 'grey' finished material which can be quickly dyed in factories according to fashion demands. In this way Benetton are able to substantially reduce lead times required to respond to fashion and customer demand.

These are possible areas we might look to in a business logistics system to reduce order lead times. Having determined what the service level should be, we can proceed to design an appropriate system. The output of a logistics system is the service level the customer receives, but what steps should we take in implementing this and what are the considerations in designing the optimal business logistics system? Figure 6.8 outlines the steps in this process, and we then examine each of these steps in turn.

Step 1 Establishing the importance of logistical service elements to customers

We have stated that the design of a business logistics system should start with customer needs with respect to service elements provided by the system. It is important to establish what these are, e.g. do customers require speedy delivery or is reliability of delivery more important? Do customers require flexibility in dealing with say, special orders, or do they require only standard products? Not only is it essential to establish customer service needs, but the relative importance attached to each need is required. Both needs and relative importance may vary between different industries, different customers and for different products supplied to the same customer. Such differences can be used to segment and target markets where the basis of segmentation is differences in sensitivity to different service levels. Here car companies like Nissan, Toyota and Honda demand deliveries to be made within time windows of four hours or less.

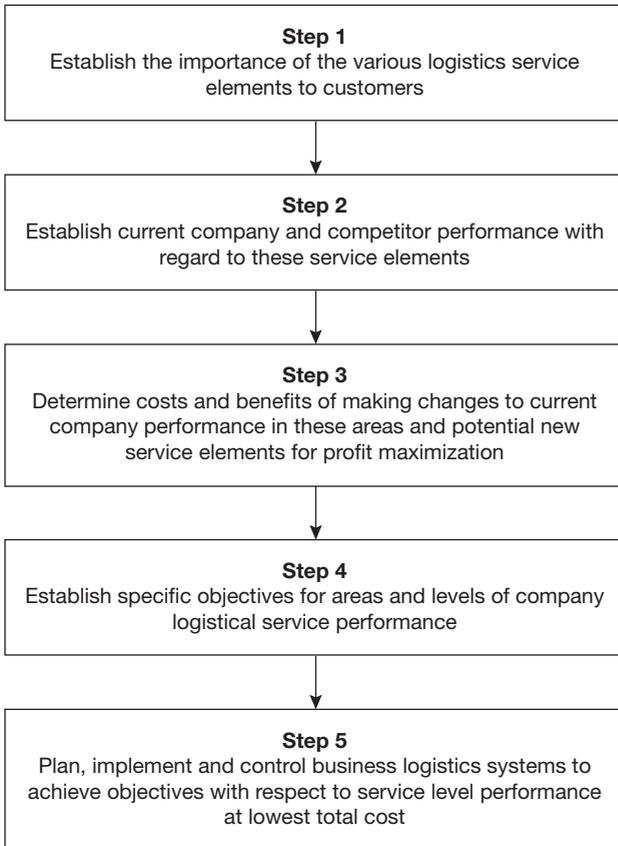


FIGURE 6.8 Designing the business logistics system

Step 2 Establishing current company and competitor performance with regard to service elements

The next step is to establish how well the company and its competitors are performing in areas of logistics services seen as important by customers. Underperformance will result in lost sales. There are significant marketing opportunities available to a company that is able to improve service performance. In assessing competitor performance we also need to look at areas where we are significantly outperforming our competitors to assess whether or not our extra performance justifies the additional cost of providing it.

Step 3 Determining costs and benefits of making changes to current company performance in levels of logistical service: profit maximization

Before we make decisions about specific objectives for service elements and design of the logistical system to achieve them, we need to assess likely costs and benefits and profit potential associated with different service levels. This brings us to an important point about the overall design of the

logistics system. Improvements in these services are likely to be costly. In determining the appropriateness, or otherwise, of current logistical services and any proposed changes, we need to assess the impact on company profits. The optimal logistics system is not likely to be one that operates at lowest cost, as we may lose too many sales, nor is the optimal system likely to be one that generates greatest demand, as these sales will probably be generated at too great a cost. The best system generates maximum profit where the logistics contribution is maximized. The notion of optimizing profit contribution is shown in Figure 6.9. We see that maximum contribution is obtained neither at the lowest nor the highest service levels. Too low a level of service and we lose revenue; too high and we incur too high costs for extra revenue generated. In theory, maximum contribution is obtained where the marginal cost of additional service levels is equal to the marginal revenue generated by these additional service levels. In reality, deriving the revenue curve with respect to different levels of service can be difficult. Nonetheless, steps of identifying customer service requirements and current company/competitor performance in this area should give some indication of likely responses to increases/decreases in service levels.

In practice the system should be designed from a demand perspective. Following earlier analysis of customer needs, we should define service level objectives based on the role we have determined for logistical services in overall competitive strategy. The design of the total logistics systems should be aimed at delivering this pre-determined level of logistical services at minimum cost.

Step 4 Establishing specific objectives for areas and levels of logistical services

Overall objectives for logistical service levels need to be translated into specific objectives for the various areas of logistical service. Possible customer service elements have been outlined in Tables

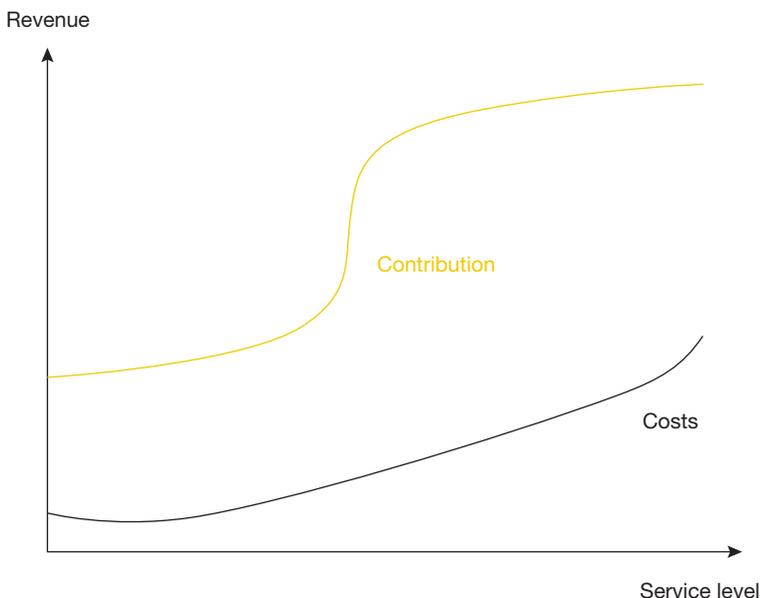


FIGURE 6.9 Contribution vs. revenue and costs

6.2 and 6.3, but we need to set quantified objectives for order cycle times, response to emergencies and order cycle time consistency.

Step 5 Planning, implementing and controlling the logistics systems

From a marketer's perspective, planning, implementation and control of logistics is paramount in providing the level of service support needed for customers. This involves purchasing, inbound transport, production, planning, inventory control, warehousing, order processing and outbound transport. Even though customer and market needs must be paramount when designing a logistics system, this can only be achieved through expertise in functions like materials management and production planning and control. In addition, we need to consult channel members and suppliers. We should note that continued operation of an effective logistics system requires ongoing information from sales and marketing including sales forecasting, customer feedback and competitor information. Of all the elements of the marketing mix, perhaps the 'place' element requires more inter- and intra-firm communication and co-ordination than any other.

Having established what types and levels of customer service the logistics system is to provide to support a competitive market strategy, the task of the logistics manager is to provide this at minimum cost. Here it is important for the marketer to understand and recognize the existence of 'trade-offs' between the elements of the logistics system. We have already come across the notion of a trade-off, but in this case it is for the system as a whole where the costs of the total system are traded off against revenue. In planning and operating the system the logistics manager must make trade-offs between individual elements of the system to achieve the desired levels of customer service at minimum cost. This requires what logistics planners refer to as a '**total cost approach**' that recognizes interdependence between the demands of logistics activities, e.g. minimizing costs in one area like inventory may lead to more than proportional increases in another, say transport.

Effective planning, implementation and control of the business logistics system is greatly enhanced by the introduction of a service policy and quantified service standards. Again, these need to be determined on the basis of customer and market needs. Service policy should include written statements concerning levels of customer service in the form of promises to customers which the company will fulfil. These can represent both a powerful promotional tool in helping to secure and keep customers, and a way of informing staff about the role and value of a logistics service in overall company and marketing strategy. Policy statements may be relatively simple, such as 'all orders received by noon will be shipped the same day' or more elaborate, covering in detail factors such as time, condition of goods, order communication and service contingencies. The policy statement may then be translated into detailed operating standards for the logistics system. In turn, these standards form the basis of the logistics control system, against which logistics inefficiencies and service problems can be quickly addressed.

DEVELOPMENTS AND TRENDS IN LOGISTICS

A number of developments and trends in the area of logistics have implications for the marketer with regard to the design and operation of their marketing logistics systems. Some of the more important of these developments and trends are now outlined.

Information Technology and logistics

As we have seen, the impact of developments in IT on marketing management has been profound. This impact is particularly pronounced in the area of logistics with IT acting as an enabling factor in more effective logistics management. There are a number of major trends that are having an impact on the use of IT in logistics. Integration and flexibility are important. Advance transaction processing systems which enable management to monitor inventory at all locations throughout the organization are commonplace. The level of flexibility and sophistication in software is continually being enhanced, enabling organizations to manage the whole supply chain system to give them competitive advantage. We have seen developments such as **Electronic Data Interchange (EDI)** where customers and suppliers interact through an on-line system to conduct transactions. EDI is not a new concept, but increasingly the emphasis on the way it is being used is moving from one-off tactical benefits to strategic benefits i.e. its use for developing closer supply chain relationships. Suppliers and customers are now able to work more closely for mutual benefit by co-ordinating integration. A series of developments in IT has enabled a totally paperless supply chain.

Much IT hardware is small, fast and cheap enabling it to be implemented in parts of the logistics process that were previously never considered because of space and cost considerations, e.g. the use of hand-held bar code scanners. Various developments such as point of sale terminals, satellite tracking, electronic funds transfer and EDI systems have resulted in substantial gains in logistical efficiency.

Another area of IT development that has affected logistics is developments in mobile communications. The growth of cellular technology-based mobile voice communications and developments in digital service provision offer the possibility of voice and data services, and more one-to-one contact has led to better client–supplier relationships. Developments in computing power and software systems have enabled marketers to cope with the complexities of managing interactions and trade-offs.

Channel partnerships/supply chain management

The earlier example of Toyota illustrates that the notion of developing channel partnerships with a view to managing the overall supply chain is not new. However, companies like Marks & Spencer have developed effective channel partnerships and supply chain management; Toyota is different, in that they work to 4-hour tactical time windows for delivery of critical supplies whereas Marks & Spencer's time windows are longer and less critical from an operations point of view. In part, this is linked to the application of IT inasmuch as this technology facilitates the complex management and exchanges of information required for effective channel partnerships and supply chain management. Channel partnerships take many forms, ranging from simple information sharing and joint facilities like warehousing through to joint management of the whole supply chain by its members. **Supply chain management** includes every facet of the supply chain from the manufacturer through to raw material suppliers. The **demand chain** refers to the chain from end customers to the manufacturer. The supply chain plus the demand chain is known as the **value chain**.

As one would expect, much greater trust between different members of the supply chain is required together with exchanges of information. This is one reason for the growth of the relationship marketing approach that is explored in more detail in Chapter 9. As a result of supply chain management, companies use a smaller number of suppliers so these must be 100 per cent reliable.

The output of the logistics system is the level of service received by the customer, so effective supply chain management must reflect this. An interesting further development that reflects this output-based view is the growth of the concept of **enhanced consumer response (ECR)**. Initially developed in the USA for manufacturing industry, ECR represents the application of total supply chain management to the retailing sector with Asda supermarket group being one of the first companies in the United Kingdom to adopt this. By working in close partnerships with other members of the supply chain, not only as regards logistics, but also in areas like promotion, product development and packaging, they have found that non-essential costs can be cut out of the system.

THE INTERNET

The trend in logistics planning has been to minimize levels of stock held. One of the problems for Internet marketers is that although it is easy to place an order, many sometimes fail to deliver. In the run-up to Christmas 2009, some disgruntled customers who ordered Christmas presents via the Internet found they were not going to be delivered until the middle of January. Internet supply requires holding larger stocks than would be considered 'normal' in conventional channel systems. However, it has beneficial effects on managing logistics. Effective supply chain management requires good communication between channel members and from the extent to which the Internet facilitates this we see advantages that accrue through the application of Internet technology to logistics.

International/global sourcing

Global aspects of marketing are covered in detail in Chapter 16. A trend with regard to logistics and supply chain management has been the growth of a more international and global outlook with regard to sourcing. In part this is a reflection of a more global outlook in company operations, but it has also been facilitated by developments in communication, transport and infrastructure which make it easier for the marketer to consider sourcing components and supplies from any part of the world according to which offers the best competitive advantage.

SUMMARY

The need for effective distribution channel management is exacerbated when economic conditions turn down. Distribution arrangements are relatively long term in nature so channel decisions tend to be strategic rather than tactical or operational. As a result, manufacturers need continually to monitor the distributive environment and reassess their existing channel structure with a view to exploiting and capitalizing on any changes.

Channel strategy must be derived from channel objectives. Commonly, such objectives are derived from profit growth, return on investment and sales growth. Because of the strategic nature of channel decisions, a decision to change them is infrequent as such a move would be high risk, often requiring the approval of senior executives within the company. We need to consider the way a company is perceived in the marketplace so any change in channel selection can radically affect perceptions of the company.

Three major strategies are: *intensive* (every available outlet), *exclusive* (a single outlet) and *selective* (a few outlets). Each has merits depending on the type of product made by the company. Despite relative advantages and disadvantages of each strategy, there is often a trade-off in selecting the right one e.g. if a company decides on a strategy of intensive distribution, it might lose some control over the marketing of its products. To maintain control of its own destiny, the company needs to assume greater participation in each of the marketing flows. Differences between *conventional marketing systems* (based on isolated and autonomous units) and *vertical marketing systems* (where participants desire interdependence) are important.

The role of intermediaries in the management of channels is critical in that each channel member has a *position* and a *role*. In this context, 'position' is defined as where each channel member chooses to locate in the overall scheme of things, and 'role' refers to the functions and degree of performance expected of the firm filling the position.

As in all forms of organization, the interaction of people, companies and organizations will inevitably lead to some form of conflict. If handled properly, good management will result in more rational and functional collective decision making within the channel. We need to understand that there will always be some element of conflict when organizations interact.

Distribution can present opportunities for gaining distinctive competencies relative to competitors. While an enterprise can offer good products at competitive prices, when communicated effectively to the right people, this can be let down if products are not available in the right place and at the right time.

Physical distribution represents a substantial cost element in business, but managed as a total logistical system it can be a powerful competitive tool which is a major issue in supplier choice. Effective management of logistics requires a total systems approach. This makes management of this area complex, requiring effective co-ordination and organization of a large range of elements, cutting across different functional areas of the company. Levels and elements of customer service need to be based on an appraisal of customer requirements and in particular levels of service they value and will pay for and what competitors are offering in this respect. This can be translated into likely costs (to the marketer) and benefits (to the customer). Service levels should be designed to maximize the logistics contribution.

Developments in IT and the Internet have produced sophisticated systems of logistics management. We have witnessed the growth of total supply chain management and increases in numbers of channel partnerships.

KEY TERMS

Intensive distribution	193	Title flow	194
Selective distribution	193	Information flow	194
Exclusive distribution	193	Conventional marketing channels	194
Physical flow	194	Vertical marketing systems	194

Corporate vertical marketing	194	Logistics	214
Franchises	195	Lean production	215
Voluntary groups	197	Just in Time (JIT)	215
Co-operative groups	197	Physical distribution	218
Administered vertical marketing systems (VMS)	198	Materials management	219
Horizontal conflict	206	Economic order quantities (EOQ)	221
Intertype conflict	206	Total cost approach	227
Vertical conflict	206	Electronic Data Interchange (EDI)	228
Channel captain	207	Supply chain management	228
Noise	208	Demand chain	228
Superordinate goals	209	Value chain	228
Communications noise	210	Enhanced customer response (ECR)	229
Multi-channel systems	212		
Systems approach	214		

CASE STUDY

Starfish (channels of distribution)

The founder of Starfish Products is Pandora Truelove who started by making jewellery as a hobby at home. Eventually Pandora began to sell some of her jewellery at small craft fairs in the district where she lives. Her jewellery proved to be very popular, especially amongst the age group 14–18. It was low priced, but well made and very fashionable. Quite simply, Pandora discovered that not only was she good at making jewellery, but she had a feel for the market and jewellery fashions that would sell to younger customers.

From this humble beginning, in just three years Pandora has expanded her business and sales to the point where she now works full-time and employs three people helping her

make the jewellery in a small workshop. At the moment she is selling mainly through craft fairs, but now at much larger national events.

Pandora wants to expand the business; demand is still strong and she has retained her flair for judging the market. She has the option to move to larger premises where she could take on more production staff. She has a small budget for promoting her products. Her main problem in relation to expanding the business she feels is distribution. To expand quickly she must secure retail outlets on a national basis through which she can market. Alternatively, she has considered whether franchising might be an answer, with sales direct to customers in their own homes rather like Tupperware or Ann Summers parties.

CASE STUDY QUESTION

What distribution alternatives might be available to Pandora to expand her business, and what are their relative advantages and disadvantages?

CASE STUDY

Radiance Products (logistics)

David Cundy is feeling the pinch. He is marketing manager of Radiance Products, a company supplying lighting components to companies that in turn supply some of the major car manufacturing plants in the UK. His customers' customers include companies such as Honda, Ford and Toyota. He has had several complaints recently from his customers concerning the level of service his company is providing with regard to some key areas. These key areas include the following:

- *The order cycle time:* this is felt to be too long compared to what the industry

requires. Companies like Honda are constantly looking for reductions in this time.

- *Order status information:* customers complain that it is difficult to obtain information regarding the status of particular orders when they enquire. Currently a customer can only enquire about order status through writing or the telephone.
- *Responding to emergencies:* Cundy's company is not felt to be flexible enough when it comes to dealing with unplanned events, such as emergency orders.
- *Damaged goods:* Cundy's customers are beginning to insist on a zero defects policy. Currently, the defect rate is approximately 0.25 per cent of products delivered.

CASE STUDY QUESTION

What steps can David Cundy take to improve the design and operation of the business logistics system in Radiance Products?

REFERENCES

- 1 McCammon, B.C., Jr. (2008), 'Perspective for distribution programming', in A. Coughlan, E. Anderson, L.W. Stern, and A.I. El-Ansary (2008), *Marketing Channels*, London: Pearson International Edition.
- 2 Ozuem, W., Howell, K.E. and Lancaster, G. (2008), 'Communicating in the new interactive marketplace', *European Journal of Marketing*, 42(9–10): 1079.
- 3 Lancaster, G. (1993), 'Marketing and engineering: can there ever be synergy?', *Journal of Marketing Management*, 9: 141–53.
- 4 Ibid.: 143–4.
- 5 Womack, D. (1992), 'Developments in production', *Business Quarterly*: 19–22.
- 6 Bolwijn, P.T. and Kumpe, T. (1990), 'Manufacturing in the 1990s – productivity, flexibility and innovation', *Long Range Planning*, 23: 44–57.
- 7 Dion, P.A., Banting, P. and Halsey, L.M. (1990), 'The impact of JIT on industrial marketers', *Industrial Marketing Management*, 19: 42.
- 8 Oliver, N. (1991), 'JIT: issues and items for the research agenda', *International Journal of Physical Distribution and Materials Management*, 13: 3–11.

- 9 Lynch, R. (2006), *Corporate Strategy*, 4th edn, Harlow, Essex: Prentice-Hall, pp. 308–10.
- 10 Womack, D., op. cit., p. 25.
- 11 Frazier, G.L., Maltz, E., Antia, K., and Rindfleisch, A. (2009), 'Distributor sharing of strategic information with suppliers', *Journal of Marketing*, 73(4): 31–43.
- 12 Perreault, W.D. and Russ, F.A. (1976), "'Physical distribution" in industrial purchase decisions', *Journal of Marketing*, 40: April.
- 13 Hutt, M.D. and Speh, T.W. (2009), *Business Marketing Management: B2B*, 10th edn, Cincinnati: South Western Educational Publishing.
- 14 Manna, D.R. (2008), 'Just-in-time: case studies of supplier relationships across industries', *Journal of Applied Business Research*, 24(1): 75–83.
- 15 Jayaram, J., Vickery, S. and Droge, C. (2008), 'Relationship building, lean strategy and firm performance: an exploratory study in the automotive supply industry', *International Journal of Production Research*, 46(20): 5633–49.
- 16 Ballou, E.H. (1987), *Basic Business Logistics*, 2nd edn, Englewood Cliffs, NJ: Prentice-Hall.
- 17 Firth, D. (1988), *Profitable Logistics Management*, Ryerson, Canada: McGraw-Hill.
- 18 Shang, J., Yidrim, T.P., Tadikamalla, P., Vikas, M. and Brown, L. (2009), 'Distribution redesign for marketing competitiveness', *Journal of marketing*, 73(2): 146–63.
- 19 Firth, D. op. cit.
- 20 Ballou, E.H., op. cit.